

Real Estate Owned – an everyday perspective

These days when you hear about “*real estate owned*” it is usually in the context of bank-owned real estate taken through foreclosure. This loses sight of the fact that real estate is owned by people, estates, trusts, and companies. Real estate is still a major component of the balance sheets of many companies and still a viable long-term class of investment; without real estate, companies could not function.

This issue of the Greenfield Advisor is devoted to real estate owned by long-term owners and users. With real estate being such a large component of the wealth of American individuals, estates, trusts and companies, it cannot be ignored. At Greenfield Advisors, we believe in proactive management of owned real estate: just “letting it ride” is the equivalent of ignoring the change that is happening in our economy.

Deflation is not our friend

Decreasing prices may be good for consumers in the checkout line, but it hurts the economy overall. Lower prices are hitting the manufacturers and sellers of durable goods particularly hard. The fundamental issue is that sales slow because purchasers are less inclined to buy today when they may be able to buy the same goods later at a lower price. This creates a hardship for retailers which transfers to manufacturers who employ the people who purchase consumer goods. The same is true for businesses contemplating the purchase of equipment. Lessened consumer demand causes retailers and equipment manufacturers to put off equipment purchases because they are not expanding or trying to conserve capital in order to get through times of lower demand for the products or services they sell.

Real estate is the king of durable goods. Ironically, it is so durable that it is rarely classified as a durable good.

Deflation is particularly hard on real estate. We have all observed its effects. Buyers delay optional purchases until the market price reaches the bottom. Owners have trouble selling their homes when they need to relocate due to changing job circumstances. Most real estate owners have watched the equity in their property decrease, leading to reduced wealth and lessened purchasing or borrowing power. Some potential real estate owners will rent instead of buying. Troubling economic circumstances can cause both borrowers and renters to fall behind in their payments, adding further pressure on beleaguered lenders and landlords.

This is truly a vicious cycle. But this is only a cycle. We have watched the real estate market rise and fall for decades. One thing is certain: real estate will bottom and then lead the recovery for the whole economy. The other certainty is that the market will be different coming out of the trough. During every real estate down-cycle changes have been made to prevent the causes. These are typically regulatory changes and we are seeing these wheels in motion today. Smart real estate owners will take this opportunity to plan for the new real estate market.

Real estate prices are a function of supply and demand

Real estate, like all goods, is priced according to the laws of supply and demand. Economic factors on a global scale drive economies and consumer behavior. Consumers are very quick to adapt to their situations. Accordingly, we can say that demand is very elastic.

One of the fundamental reasons why commercial real estate cycles so widely is that the supply of property is essentially inelastic. Buildings last so long that they are rarely removed from the market. Accordingly, the inventory of available space is quite slow to react to changes in market demand and an oversupply situation results. This puts downward pressure on prices in a down-cycle and causes prices to decline rapidly.

Because buildings take so long to construct means that in times of high demand the supply is constrained and an undersupply situation results. This puts upward pressure on prices and causes prices to rise rapidly.

The very factors that make real estate such a long-term investment also cause more dramatic swings in prices. Accordingly, real estate owners must plan ahead and anticipate changes in market conditions. We are seeing this today as lenders write down mortgage balances, landlords reduce rents, and concessions are given. These actions are designed to keep the real estate occupied.

Unoccupied, unproductive real estate is a drain on real estate owners due to fixed expenses. We have observed retailers and office building owners reducing rents rather than removing tenants for these very reasons. When a lack of occupancy becomes pervasive, as we have seen in some particularly hard-hit neighborhoods in Michigan, even occupied real estate suffers due to changes in neighborhood micro-economic conditions such as ruinous competition and blight.

As we noted, home value inflation caused a surge in the ownership rate. Similarly, deflation causes a decrease in the ownership rate. This shift is acutely evident as we see units in condominium projects being rented and some projects being undeclared and reverting to apartments. When people are forced out of their homes through foreclosure, they become renters. When people sell their homes and relocate to a market that is still in a decline, they tend to rent rather than buy into a declining market.

Real estate owners need to plan for how the market will look in the future rather than to simply hope that the old market will reemerge. We have noticed from prior cycles that consumer confidence and financial ability will be impaired for the better part of a decade. This is clear from the steep rate of decline and the slow rate of recovery witnessed in prior real estate cycles.

Real estate is still owned

Still, when we look out our windows we see real estate. People live in it and businesses house their workers and goods in it. The real estate is not to be blamed for the economic circumstances; rather the characteristics of real estate that make it such a good long-term investment are to be blamed. Most real estate is productive and necessary to our civilization.

Over the course of many cycles, real estate tends to provide functionality in addition to being an investment vehicle. Since before the Great Depression, each long-term cycle has shown the price of a standard US house to make higher highs and higher lows after adjusting for inflation according to the Yale economist Robert Shiller, creator of the S&P Case-Schiller indices. These are characteristics that every technical analyst desires. We see this as due to two overriding factors: the first is increasing demand due to population growth and the second is the adaptation of the real estate product by the producers of new space.

Looking forward, we see no end to increasing population but see acceleration in the adaptation of real estate to match future market trends. For the developers of new space this means energy efficiency and adapting to companies who desire to do more with less. For owners of existing space this can mean repositioning, retenanting and retrofitting. Real estate design and space implementation must stay closely aligned not with the users of the past decade, but with the users who will be using it for as long as it stands.

Now is the time for planning

The market has taken a pause. In some quarters, the only action is reactionary. However, nearly all of America is living in the home and businesses are still occupying space. This will continue. Real estate will remain a significant asset on many balance sheets. The smart real estate owner will make productive use of this lull in activity to plan for the future. Planning ones real estate needs must be done months or years ahead in order to anticipate future trends.

Investors would be well advised to invest in creating a future vision for their real estate portfolio that both survives the current downturn and builds toward the direction that market demand will follow during the next up-cycle. This may involve acquiring, planning for development, repositioning, retenanting, redeveloping, or selling real estate assets.

Business users of real estate should think about doing more with less and re-examined their real estate holdings with an eye to identifying surplus real estate that can be sold or turned into productive use and to configure the space needed for their operations to more closely match their forecasted long-term needs.

Any action should be preceded by a thorough analysis of the highest and best use of their properties both individually and as a portfolio. This analysis must consider both short- and long-term market trends at the macro- and micro-levels. Rarely does everything go according to plan. For this reason, planning should also include a risk analysis that reflects the uncertainty of the timing and magnitude of change as we go through economic cycles and as to examine the range and pattern of the evolution of desires and needs of future users of real estate.

Greenfield Advisors' response

Some companies hire real estate experts in their real estate departments. Small- and medium-sized companies may have real estate departments that are dedicated to the on-going operation of their real estate holdings (owned and leased) or may assign these tasks to operations, finance or senior management. Trust, estate and family office administrators oftentimes administer real estate as a fiduciary in addition to handling many other matters. Everyone knows something about real estate but not everyone is an expert real estate analyst or asset manager.

We anticipate that our client base will become more sensitive to how real estate impacts the future of their balance sheets and the profitability of their companies. Accordingly, we have instituted a program that will provide ongoing assistance to our clients as they optimize their real estate holdings. This assistance may range from providing manpower for special projects to providing the functionality of a fully staffed real estate department.

My Real Estate Department

Greenfield Advisors is proud to present the **My Real Estate Department** program which provides full-service and supplemental real estate advisory services to small-medium companies, trusts, estates, family offices, working in concert with their administrators, officers, real estate departments and advisors. **My Real Estate Department** presents a single source solution for entities with real estate interests in the United States and in some other countries.

Through this program, Greenfield Advisors provides hands-on and advisory services on an on-going basis for organizations that don't have in-house real estate staff but need occasional real estate assistance as well as for organizations that have real estate capabilities but need outside manpower or expertise for special projects or that need input from an objective third-party. Greenfield Advisors also provides objective fair value reporting (FASB 157) for real estate assets and IRS qualified appraisals for donations and contributions. Services are provided as-needed, when needed.

Through My Real Estate Department, real estate owners can get ongoing assistance through critical points in the life-cycle of their ownership starting with strategy and acquisition; through ownership and operations (financial reporting, asset management, planning, redevelopment, funding and leasing); to disposition. For companies that lease real estate Greenfield Advisors can assist with needs assessment, model building (for purposes of location-specific sales forecasting) for site selection and market planning, lease negotiations, build-out and lease auditing.

Enrollment in My Real Estate Department includes a web site that provides a central repository for collaboration and maintenance of real estate information. Current and relevant information is stored in each client's password-secured area. Permissions are granted only to key personnel and advisors identified by the client. Clients are provided views of their real estate holdings using the latest mapping and visualization tools.

The secured site provides transparency and immediate access to information. This is particularly important for stakeholders who live in different areas and have varying degrees of involvement in the real estate but who want to be informed. Greenfield's work and key documents can be easily accessed by stakeholders from anywhere. If someone wants to review construction documents, plans, monthly property management reports for a property or see the timeline for a maintenance or redevelopment plan, that information is immediately available. Everything is transparent. Naturally, My Real Estate Department can also be used to provide General Partner reporting to Limited Partners, and can be customized on a partner-by-partner basis.

As you know, Greenfield Advisors has over thirty years of experience managing and advising on complex real estate. For example, we are one of the nation's leading experts in the valuation of contaminated properties which can be particularly important for financial reporting. My Real Estate Department provides an efficient opportunity for every commercial real estate owner to gain access to the same level of service previously obtainable only by larger companies with in-house real estate departments.

For more information

If you or your clients would like to delegate real estate issues or special projects to an outsource real estate department please contact Greenfield Advisors to explore enrolling in our My Real Estate Department program.

<http://MyRealEstateDepartment.com>

Christopher A. Miner, MAI

Managing Director, Real Estate Advisory Services

(206) 623-2932