



Greenfield Advisors LLC

# The Greenfield Advisor

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## Gosh...where have you been?

My question exactly. Our last issue was May, 2008. We've attempted to write several new issues since then (and really DO want to produce The Greenfield Advisor on a more regular basis). However, every time we put the electronic pen-to-paper, the market has shifted so widely as to turn our "news" into "history".

In addition, as you faithful readers can probably guess, we've been terrifically busy ourselves. Since Greenfield is best known for real estate problem-solving, it's been a pretty exciting season.

To cure the problem, we've expanded the editorial board from one (yours truly) to three with the additions of Dr. Max Kummerow and Dr. Marc Mueller. Frequent readers of The Advisor will recognize these names. Dr. Kummerow will focus his attention on environmental issues and complex real estate models, while Dr. Mueller will bring us his expertise in high-end trophy property. I will continue to focus my attention on "big picture" issues and the economy. In general, we'll rotate the writing monthly, so that The Advisor will **hopefully** come to you on a more regular basis!

## Is it over yet?

I don't know anyone in finance who has enjoyed the past few months. As one investment banker put it to me earlier this month in New York, "If you were running a \$100B fund a couple of months ago, you're running a \$70B fund today." What's worse for the real estate market, a fund which had an allocation for real assets now finds itself over-weighted with those assets.

As a simple example, if your \$100B fund had a 5% allocation, then you had \$5B in real estate. Even if your real estate values haven't moved (which is often the case, particularly if you bought well), then you now have an allocation of ( $\$5 / \$70 =$ ) 7+%. Your mathematical models (yes... the very same models that got you into this mess in the first place) are signaling to sell or HOLD real estate and buy more equities.

Of course, if you bought highly-leveraged real estate debt instruments, your models all imploded a few weeks ago, and you're busy filling out a job application at McDonalds.... who, we hear, are grabbing market share away from the more expensive Starbucks. Go figure.

But enough about how we got here. The real question is, where is all of this headed? Naturally, with a new president who has a mandate for "change" and a system that most people agree needs to be overhauled, trying to ferret out the future is a task well beyond the scope of psychics and palm readers. However, we can make a few observations that seem within the bounds of predictability.

1. The pundits are yelling about the **next** crisis, which is thought to be credit card debt. We note that credit card issuers are already feeling the pain, and the FED recently announced that it would begin applying much more stringent banking rules to American Express. The real problem will be the impact on domestic consumption, which is really a 4<sup>th</sup> quarter phenomenon. The Christmas holiday season will tell us a lot, and we'll probably get a gauge from the Thanksgiving

weekend, just a couple of weeks away. Major retail bankruptcies seem to be a daily phenomenon, and Nordstrom's just announced major price cuts on over 800 items. The ripple effect on retail real estate could be very real if major portions of big-boxes and regional malls go dark.

2. We will, of course, weather any credit-card crisis which comes along. The American economy is certainly more resilient than that. Of more serious impact, however, will be the tax crisis. When a conservative republican president takes steps to nationalize major portions of the U.S. economy, it begs the question of what his liberal democratic successor will do. All of this rests on the premise that the economy can tax income enough to pay its bills. What we know is that this is already proving to be problematic. An early canary-in-the-coalmine has been the near freezing of the low-income tax credit markets. Six months ago, tax credit syndicators couldn't find enough deals – there was huge demand to buy tax credits at record-high prices. Today, the market has nearly gone dark, as no-one is buying tax credits. Why? They don't foresee any 2009 taxes against which to apply the credits. A report in the Wall Street Journal this week points out that while Wall Street only accounts for about 2% of New York workers, it has recently accounted for over 20% of New York wages (yes, that means Wall Streeters were paid **very** well.) With the collapse of so many investment banks, and the curtailing of bonuses at others, New York's coffers will be much dryer than usual next year. Add to that the dearth of taxable corporate profits, and we can only hope Exxon pays **its** tax bill on-time.
3. By one report, for-sale-by-owner homes and distressed inventory now constitute 42% of the total homes for sale nationwide.
4. Is there good news? Sure – and a surprisingly large amount of it. China is coming off its hoard of Dollars and Euros to stimulate its own economy and finally start shifting some of its trade surplus into consumption. That's great news on two fronts. First, we knew they would eventually have to do that (or run out of places to store the money) and doing it now, rather than later, insures against the potential inflationary effects of such a spend-down. Second, shifting China into more of a consumption mode is one of those rising tides which will lift all boats.
5. In addition, the marginal shift of millions of households from home purchasing to home renting lifts rents and lowers vacancies, which improves the fundamentals of the investment real estate equation. Couple with that a lower interest rate market and housing price deflation, and you end up with a very attractive real estate market. Remember – real estate has beat the stock market not only in the recent short-term, but also over the past decade.
6. Europeans are coming back into the U.S. real estate market in a big way. They don't really understand it, but they know it's cheap. In addition, there is some indication that the Euro/Dollar run, which has favored the Euro for so many years, may be at least at a plateau. This suggests a great buying opportunity for Euro-denominated investors.
7. Finally, there are already signs that the real estate credit markets are figuring out how to work within the new paradigm. While credit markets certainly haven't **eased** yet, there seems to be less uncertainty than a month ago.

Despite all the doom-and-gloom, this housing down-cycle really looks less formidable than the S&L crunch of the late 1980's. In that one, builders, developers, lenders, and investors were badly over-extended and under-capitalized, and it took many months for the U.S. government to finally step in and take restorative steps. Once those steps were taken, the markets were fixed quite quickly and at a price tag somewhat lower than had been predicted. This time, the government stepped in quickly and there is nearly universal agreement on the need for corrective action and subsequent overhaul. As such, we continue to be realists, but probably more optimistic than most. In short, the world's not coming to an end, and there are great opportunities out there in today's real estate market.

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