



Winter 2009 Newsletter

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Why Were So Many Commercial Real Estate Investors So Wrong? When commercial real estate investors stopped using logic, wisdom and history as their guide.

A Little knowledge is a dangerous thing

The key implications are when so many arrogant whiz kids got into the capital markets and showed the deal makers how by using extraordinary amounts of debt, the system could create wealth beyond their wildest imagination. The old guard fell to their needs and bowed. Not that the old guard didn't already know this, they just could not believe how fast and vast this wealth could be achieved and not by singular building by building purchases but by portfolio buying and the like.

The same thing happened with the debt structures. No longer would mortgages be doled out one at a time, they would be mass marketed like government bonds, and they would be sold to unknown investors who took the word of the rating agencies who were tasked to "underwrite" vast amounts of debt with no real knowledge of the collateral involved. This was done in almost instantaneous time frames....and no one thought this was wrong?

What is truly amazing is the fact this question is even being asked today.

What got us into this mess started with the Federal Reserve lowering interest rates to historically low levels and leaving them there believing the market would self correct?

Well self correct it did with a gigantic bang that has been heard and felt around the globe.

It was the United States consumer being fed the propaganda that the good times will last forever as long as they keep consuming. And the lenders were all too happy to keep the party going like the neighborhood drug dealer, supplying their "clients" with the drug of choice, MONEY.

The Cops on the beat AKA the Rating Agencies were looking the other way as they were being paid exorbitant fees to do just that... look the other way. There was no due diligence, as the article suggests, why in the world would one need to conduct due diligence when we all knew the rental and sales prices only could go in one direction, right?

Part of me is thinking the business schools of our dear Country must have failed somewhere in this process, because if anyone who ever took Economics 1.01 knows business has cycles even if they last 15 years. But I guess the whiz kids must have cut that lecture. Perhaps that generation which is two generations removed from the Great Depression thought there were too many safe guards built into our financial system. However, when one of the most prominent financial people in the world gets caught in a huge 20 year Ponzi scheme you have to know the system is totally broke, both figuratively and literally. When common sense is blinded by greed and arrogance the results are what we are experiencing now.

No one wanted to listen to us naysayers, we were too negative.

Why should we advise against buying at 5% and below cap rate real estate investments, with 90% debt to equity based on projected ever rising rental rate spikes and sale prices? How could we in the minority have been so blind not to have jumped on the band wagon? The answer was and still is wisdom and experience. Wisdom comes from experience.

Therefore the real issue or better said the real answer is Wall St allowed the inexperienced MBA crowd to take over because they were able to “run the numbers” in a way never witnessed before. It was like magic. The only fuel needed was the drug, easy money or credit and that was happily provided by Alan Greenspan. He, who let his ego and his thoughts of a heroic legacy blind him to the reality of what was happening to the entire financial system from top to bottom.

So as this writer has said on a number of occasions, everything the Herd thought they made has been gutted. The MBA Whiz Kids, have been taught a valuable lesson, and have paid the price with the vast number of unemployed in their ranks, deservedly so. No one took the time to learn the fundamentals of commercial real estate from the street level, which is how it can only be viewed not from the Ivory Towers of Wall St. That is today’s lesson and the answer to the above.

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