

# Key Issues in 2011 for Real Estate Investors and Decision Makers



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# Key Issues for 2011

- The Economy
- Austerity
- China
- Banking
- Commercial Real Estate
- Residential Real Estate
- Investment Environment

# The Economy

- Non-farm jobs increase by 297,000 in December, a big surprise
- Union Pacific has rehired 4000 of 5000 laid off workers
- The Architectural Billing Index rose above 50 for the first time since 2008.
- Small businesses added 91,000 jobs in November.

# The Economy

- Household net worth increased to \$54.9 trillion in 3Q, up from \$53.7T in 2Q.
- There is \$1.93 trillion in cash on corporate balance sheets.
- Cash accounted for 7.4% of total assets, highest since 1947.
- Winnebago says 2010 shipments doubled from 2009; have rehired 350 workers
- Farm income will be the 4<sup>th</sup> highest ever in 2010, climbing 24% to \$77.1 billion.

# Texas Will Steal Market Share in the Coming Years

COLLEGE STATION (Real Estate Center) –

Texas' economy gained 133,100 jobs from August 2009 to August 2010.

During the same period, the U.S. economy added 278,000 jobs.

Texas produced 48% of all the new jobs in the country in the past year.

# Teamsters Organize Medical Marijuana Growers

By Stu Woo

Sept 2010

About 40 employees of an Oakland, Calif., marijuana-growing company joined the Teamsters union earlier this month, becoming what are believed to be the first pot growers to unionize in the country.

Employees of the grower, Marlyn Investments LLC, which grows pot for medicinal purposes, approached the union earlier this year, said Marty Frates, secretary-treasurer of Teamsters Local 70. The pot-grower's employees ratified a two-year contract in early September, he said.

Use of marijuana for medicinal purposes is allowed under California law, although it is still a violation of federal law. Medical-pot dispensaries are common in big California cities.

Marijuana-legalization supporters tout the unionization as a sign of the drug's growing legitimacy. The move also boosts Teamsters at a time of dwindling membership. "We've had our problems," Mr. Frates said, "so we've had to diversify."

## Bell City Manager Paid Twice President Obama's Salary Resigns

Robert Rizzo Earns Nearly \$800,000, Will Become Highest-Paid Public Pensioner in Calif.

By RUSSELL GOLDMAN

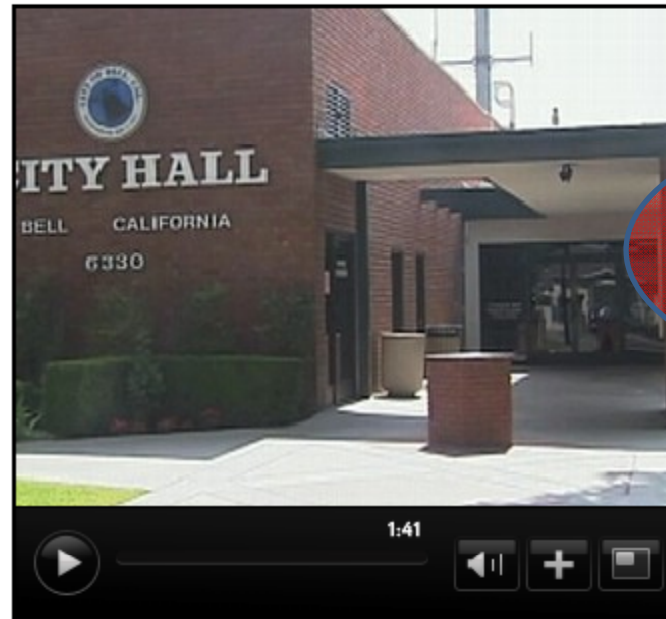


July 23, 2010

57 comments

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Three municipal officials whose outside salaries sparked a firestorm of outrage in the working-class Los Angeles suburb of Bell, Calif., resigned after midnight Friday following an emergency meeting of the city council.



The people of Bell, California, react to city administrators' high salaries.

Robert Rizzo, the city manager, will leave behind a \$784,637 annual salary -- nearly twice the pay of President Obama -- and will not receive a severance package. Nevertheless the 56-year-old will draw an immense pension, between \$650,000 and \$880,000, making him the highest-paid pensioner in California.

"Rizzo resigns and still makes more than \$600,000," said Ali Saleh, founder of the Bell Association to Stop the Abuse, a grassroots community group. "That's why I call him a predator. He's taking advantage of the community whether he keeps his job or resigns."

# Government Austerity

- “I don’t think anyone can look at the public pension funds and not realize what an enormous tragedy it is. I just hope they can work through that situation in a way that is both sensitive and compassionate.”

– Joshua Gotbaum,

Director of

Pension Benefit Guaranty Corp



# Government Austerity

- States may face a \$140 billion shortfall in fiscal 2012 on top of a \$160 billion shortfall for 2011.
- Investors started withdrawing money from municipal mutual funds in November.
- BOA, Goldman, Citi, Morgan Stanley and JP Morgan discussing standards for a CDS market for municipal bonds.



iShares S&P National Municipal Bond

# Government Austerity

- UK cuts defense budget by 8%. Slashing orders for Joint Strike Fighter from 138 to 40.
- Defense contractors will have to adjust to reduced federal spending.



# Government Austerity

- The IMF warned that reducing budget deficits is likely to cut growth and raise unemployment in the short term.
- Looking for signals from Congress when the debt ceiling is increased in March.



# Bang the Piñata

If you promise the voters more candy, they will re-elect you. Don't worry that you have no way to pay for your promises.





# Examples

- \$43 Trillion unfunded liability for Social Security and Medicare
- Prosecuting wars in Iraq and Afghanistan off-budget
- FRANNIE losses are also off-budget
- Health care plan supposed to “pay for itself” premised on the “doctor’s haircut”.
- States and cities with underfunded pensions

When the piñata breaks  
and the candy is gone



# The Short-Term Pain of Living Within Our Means: “Austerity”



So far,  
this has been  
postponed by:

- Foreclosure postponements
- Foreclosure moratorium,
- Federal subsidies  
to states and cities,
- Extended unemployment  
benefits,
- Tax credits to buy stuff.

# Here Come the Adults !



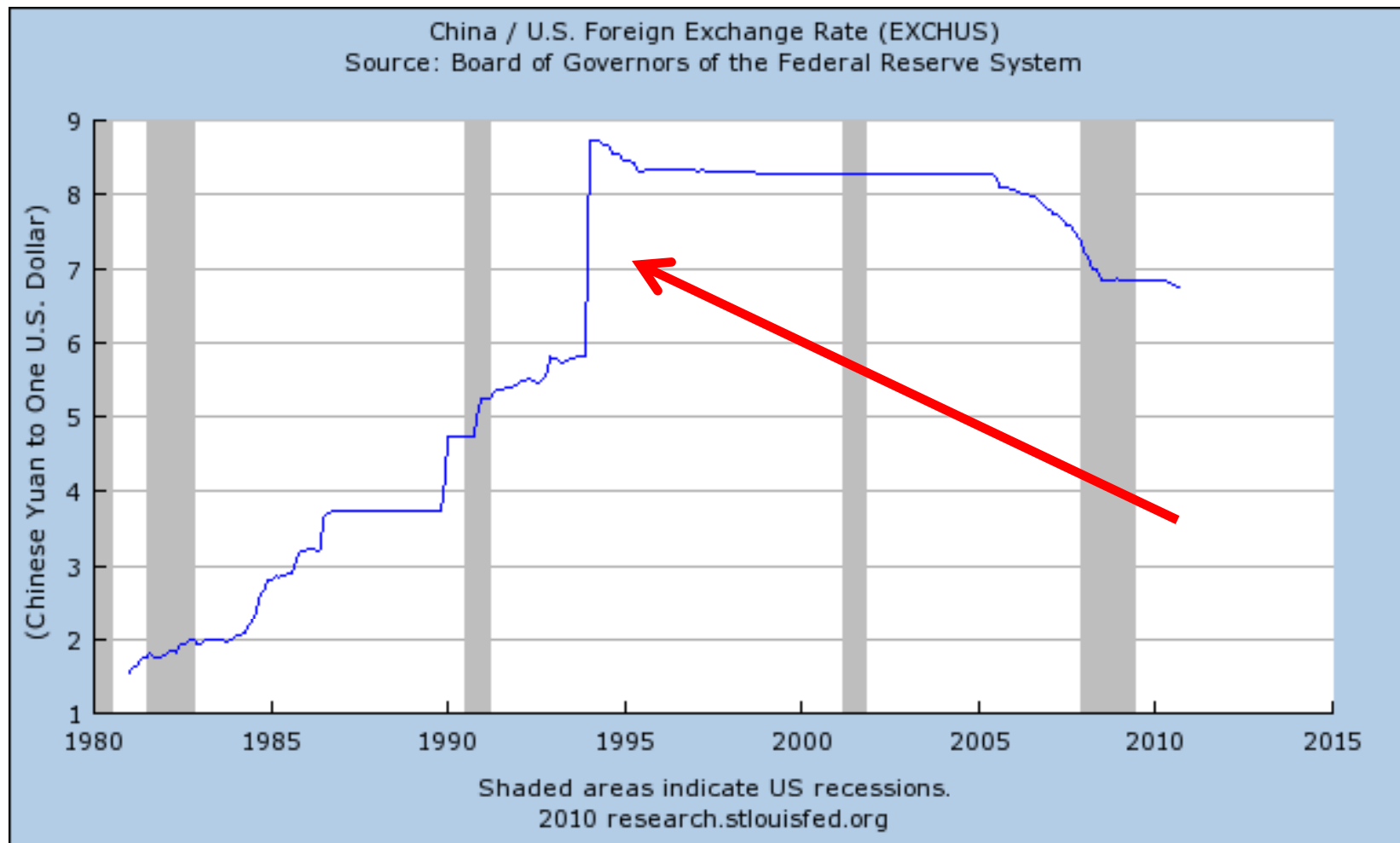
National Bipartisan Commission on Budget Reform and Fiscal Responsibility

Maybe our children and grandchildren have hope.

# China

- We need China to buy something made by American workers.
- They have accumulated \$2.6 trillion in foreign exchange reserves to peg their currency.
- Bank lending in China was 40% of GDP in 2009.
- China allows citizens to buy gold in Dec. 2010
- China imported 209 tons of gold in first 10 months of 2010, up 5x from last year.
- The Business Software Alliance estimated that 79% of the PC software installed in China last year was pirated, down from 86% in 2005.
- China controls 97% of the production of “rare earths”.

# This is What Chinese Currency Manipulation Looks Like



## Immelt blasts China

Jul 2nd 2010, 13:10 by Schumpeter



THIS week's plain-speaking prize goes to Jeff Immelt, the boss of General Electric.

He argued that [China is increasingly hostile to foreign multinationals](#); he also gave warning that his company, the world's biggest manufacturer, is actively looking for better prospects in other emerging markets. "They don't all want to be colonised by the Chinese", he said, going rather further than was prudent. "They want to develop themselves".

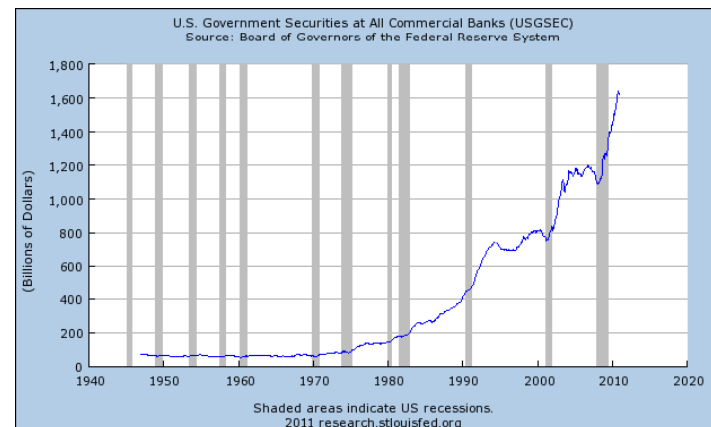
Mr Immelt's broadside was undoubtedly significant. It reflects a growing mood of disillusionment with China among big Western companies. It came from the mouth of one of China's biggest boosters, a man who praised the Chinese leadership, only last December, for doing exactly what they say they will.

Does it matter if  
GE builds a million  
turbines in China  
that are designed,  
engineered and  
manufactured in  
China?

Who does that  
help in America?

# Bank Lending for CRE

- Federal regulators warning Texas bankers about exceeding their commercial real estate loan limits.
- Federal regulators telling our Texas bankers that they are concerned about excess liquidity and that “it’s OK to buy Treasuries until we get out of this thing”.



# Commercial Real Estate



- US occupancy of office space increased for the first time in three years in 4Q10. Rents rose for the first time since 2008.
- Mall vacancy rates declined slightly over the past two quarters.
- Apartment vacancy fell below 7% in 4Q, first time since 2008.

# Commercial Real Estate

- Pending sales of condos in Miami are up 40% in December compared to a year ago.
- The high bid prices in NYC , SF and DC are “leaking” into smaller markets.
- KBS recently paid \$115 million for National City Tower in Louisville. The building last sold for \$95 million in 2005.



# Commercial Real Estate



- Double bubble in “gateway cities” in the U.S.
- Cap rates are falling again
- Apartments, hotels and industrial are leading

# Commercial Real Estate



- Mortgage rates falling and LTV ratios increasing from life insurance companies
- CMBS financing is coming back. Troubled loans are being worked out and/or extended.
- But bank loans for CRE virtually non-existent
- How will Texas finance future growth needs without bank financing?

# Commercial Real Estate

- CALSTERS backs off \$2.5 billion allocation to commodities.
- TIAA-CREF has about \$2 billion invested in farm land.
- Hong Kong placed a tax on all real estate resold within 2 years, to clamp down on speculation.



# Residential Real Estate



- Currently at the bottom of the cycle
- Will start to show improvement in late summer
- Buyer hesitance from 1) jobs and 2) price trends
- Shadow inventory scaring off buyers
- Foreclosure delays are extending the bottom
- Tight underwriting at FRANNIE and FHA
- We need a tax policy to encourage investors

# Investment



- Stock market volume is off about 20%
- Private market “dark pools” make up 33% of total stock market volume.
- Between 50-80% of volume is high-frequency trading
- Money has been flowing out of US stock mutual funds since the flash crash last May

# Investment



- Almost all mutual fund flow is into bonds for the past two years.
- Now some money leaking out of bonds into foreign stocks.
- Corporate pensions had 70% in stocks in mid-2000's, now down to 45% in 2010.
- Goldman sold 50-year bond at 6.125%, and calls bottom of bond yields.

# Investment



- Commodity speculation rampant
- One trader owns 80-90% of the LME copper.
- One trader owns 90% of the LME aluminum.
- Chinese hoarding cotton at \$1.50 per pound.

# Chinese Farmers Hoarding Cotton



# U.S. Bank Hoarding Copper

- Large U.S. bank owned 50% of all copper in the warehouses of the London Mercantile Exchange.



# The Good Scenario

- Small businesses and investors get the 'go signal' from Congress
- A positive surprise on new job creation for two consecutive months
- Stock prices jump substantially
- Interest rates rise and bond prices fall
- Massive move out of cash into stocks
- Massive move out of bonds into stocks
- Wealth effect increases consumer confidence
- Increase in spending results in more hiring
- Maybe China would buy something made by US workers.



# The Bad Scenario

- Congress continues to scare business owners
- States and municipalities fail to balance budgets
- More 'stimulus' to states, cities and counties
- New tax credits continue to distort the markets
- Continued "uncertainty" from Washington
- China continues to manipulate their currency and not buy anything made by Americans
- Business/investors continue to hoard more cash
- 10-year treasury rate falls toward 2%
- Repeat of 2010 for 2011

