

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

I. Other Presentations In Which Either The Date And /
Or Sponsoring Organization Is Missing

6. Real Estate Finance/Mortgage Banking/Mortgage
Guaranty Insurance

bb. "Madison Realtors Luncheon", no date

Madison Realtors Luncheon

I. Introductory Comments

- A. In the beginning was the void and then somebody rolled the rock in front of the cave and created real estate. Even those who landed on Plymouth first lived in caves. Caves explain 3/4 of the history of real estate.
- B. We have gone from cave per moon to apartment per month, square foot per year, tennis court hours or room nights at a motel. Space with a dimension in time is the common element. Building technology has simply served to reduce the mass of the enclosure from a mountain to curtain walls and balloon framing.
- C. Reminded of the student comment in a physics lecture where one professor was arguing that a black hole was caused as a result of a super density of mass while another professor was arguing that mass was the result of two particles on different wave lengths colliding and cancelling each other out. The student observed that for all their fancy talk modern physics didn't know its mass from a hole in space.
- D. Sometimes I think real estate doesn't know its ticky tacky boxes from a hole in space either - just cause the language is different.
- E. Thus my title - Real Estate Commodity or Dry Hole.

II. One view of real estate investment is as a commodity. Motel rooms, square foot of class A office space are all fungible units like a bushel of wheat or a sow belly and like any commodity there is more than one market and there are mechanisms to control risk in each market.

- A. Real estate investment began as a utilitarian contribution to an enterprise, enclosing an activity.
- B. Real estate then became a device for control of a captive customer for services and equity was the degree to which you could convert real estate budgets to your benefit.
- C. Real estate as a commodity was discovered when people discovered that one could make contracts for future delivery while hedging. (James Wilson Plaza)
- D. Most recently the play has been to arbitrage the commodity between markets, as in syndication, condominium converting and sub-dividing.
- E. Of course some didn't understand the technical expertise it takes to play the commodities market over to arbitrage - for those who do it successfully have a global knowledge of cause and effect impacts on supply and demand.
- F. Those folks who go through the motions without the understanding are wildcatting - drilling dry holes without the seismographs in terms of market research and basic geology. Some of the dry holes are beginning to show up around town as defaults - but default was in the dealer and not in the heaven.

- III. The space/time commodities approach to real estate analysis provides some useful insights into future trends:
- A. Housing - progressed from utilitarian to development to commodities and recently to arbitrage without fully considering the implications of the relationships of density in terms of the numbers of occupants to cubage.
 - 1. Arbitrage works as density and purchasing power rise (Langdon Street apartment conversion, Oakbridge small lots, Fauerbach condominiums).
 - 2. At the same time where densities fall in large homes prices will tumble behind, particularly where location is also disadvantageous.
 - 3. It follows that in the future to protect the values of large homes and arbitrage to markets for smaller units subdivision of big homes to 2+3 unit condominiums will become common, good for the neighborhoods, good for the home owner, and good for the realtor, and good for the folks apposing urban sprawl. (in other towns it is called accessory housing and it only requires that the exteriors of the home cannot be modified.
 - B. Rental office buildings are motivated by two long term commodity based premises:
 - 1. Cost of production will never be lower, but that assumes high rise construction on downtown sites.
 - 2. That assumes that interest rates will fall in order to finance higher purchase prices without raising the rent, or
 - 3. Tenants will continue to go short in a rising market by renting instead of buying, at a time when tax laws favor buying or long term leases of custom built space.
 - 4. Or investor expectations will fall in stagnant society where there is no growth for new capital.
 - C. The square foot of retailing space is a commodity which depends on its ability to generate sales per square foot by concentrating sales from a wide geographic area at a single point. It presumes that both unit volume and prices will rise uniformly rather than simply shift geographically.
- IV. Real estate are commodity brokers but commodity commissions are much lower and real estate brokers are much higher for higher volumes traded.
- A. I predict that the number of housing sales will continue to fall as in migration into Madison drops and people stay in one place and remodel to adapt to changing needs. The average size of a home will drop from 1500 to 1200 sq. ft. The home will again become a base for family operations and a hedge against inflation but not commodity speculation as it was in the 70's. There may be some arbitraging as zoning laws are modified to permit subdivision of the bigger houses. Obsolescence in terms of energy, location and solar orientation will be setting in.
 - B. Specialization will occur in terms of both firms and sales persons that will permit a fewer number of persons to operate and accomplish the same amount of business. More charges will be on a services rendered basis and less on commission.
 - C.

- C. More families will work for the day that home mortgages will be repaid and there will be no investment advantages in leaving the mortgage outstanding while you speculate on the stock market, etc. Smaller homes and higher density will mean less urban sprawl and therefore less reason for fringe lands to appreciate. If you are buying corn land make sure it is at a price at which you can make money growing corn.
- D. Reaganomics is in part a realization that we all must live within our means, that we can't borrow from the future, from Peter to pay Paul, but our political system has never worked when it comes to dividing up the losses equitably. Thus the next four years are going to be unstable, uncomfortable, and somewhat unpredictable as to impact. The unpredictable impact is what David Stockman was articulating and for which he was misinterpreted.
- E. Virtually all elements of real estate has been overbuilt with the exception of housing, and there each unit is overbuilt but there aren't enough units in the aggregate. The opportunities in real estate in the next ten years will be arbitraging the existing space/time supply or finding new activities to enclose with existing volumes.