

TOO LITTLE TOO LATE WEB BUZZ 09.17.2007

The period from January to August 2007 has something very interesting to reveal in the real estate business. It was in February 2007 that Sam Zell sold Equities Offices Properties trust for \$39B. At that time we questioned whether this indicated the top of the commercial real estate market. In late 2005 it was apparent, at least to us, that the housing market had probably topped. January through August of this year, we received confirmation. Angelo Mozilo, chairman of Countrywide Financial, sold \$85 million of his holdings in that entity, the largest home mortgage company in the U.S. The stock went from \$40 to \$20 after this period of time. My, how good was that timing?

The point here is not to cast aspersions on Mr. Zell or Mr. Mozilo. Both of these gentlemen are living the American dream. Both are sons of immigrant parents who pulled themselves up by the bootstraps and built empires in their area of interest and expertise. Hooray for them! Our point here is that these gentlemen didn't get where they have by being ignorant of economic conditions in their respective industries. We personally would rather trust their timing as opposed to that of industry analysts, who many times are a little like the jilted spouse—the last to know.

Our guess is that Ben Bernanke will likewise note these “leading indicators” and cut the Federal Funds rate from 5.25% to 5%. If that happens, it is too little too late. Moneylenders are frozen. There is something in the neighborhood of \$1T or more out there that is lost, but we mostly don't know by whom.

How anxious and willing would you be to lend to your customers when you are not sure where all these losses reside? In the inter bank area, it's very troubling. Many have billions of dollars in off balance sheet entities, which remain undisclosed. This brings us to the crux of the inflation/deflation debate.

Please keep this in mind: the Federal Reserve does not lend to the consumer or business entity—they lend to the banks only. The key, then, is why should the banks lend to anyone when they have sustained bad loans on their books a la Japan? And as mentioned above, there are many bad loans that remain hidden in various potential borrowers' portfolios. Who has them and how much? Maybe, just maybe, the banks will collect good loans in order to pay for bad ones.