# GRANT'S

INTEREST RATE OBSERVER®

Vol. 30, No. 3a | Two Wall Street, New York, New York 10005 • www.grantspub.com | FEBRUARY 10, 2012

# America's people power

Love and marriage—and interest rates, too—are among the foremost drivers of nonagricultural land prices. Without population growth and ready financing, the asset once stockpiled by leveraged homebuilders yields only weeds and tax assessments. Now unfolding is a primer on uninhabited acres. In preview, we're bullish—at a price.

People hold the key to this market as they do to every other. From the standpoint of the land on which developers build, you can hardly have too many people. Lots of growing families are what a landowner roots for—that and growing incomes and an end to the alarming trend of adult children returning home to live under the parental roof.

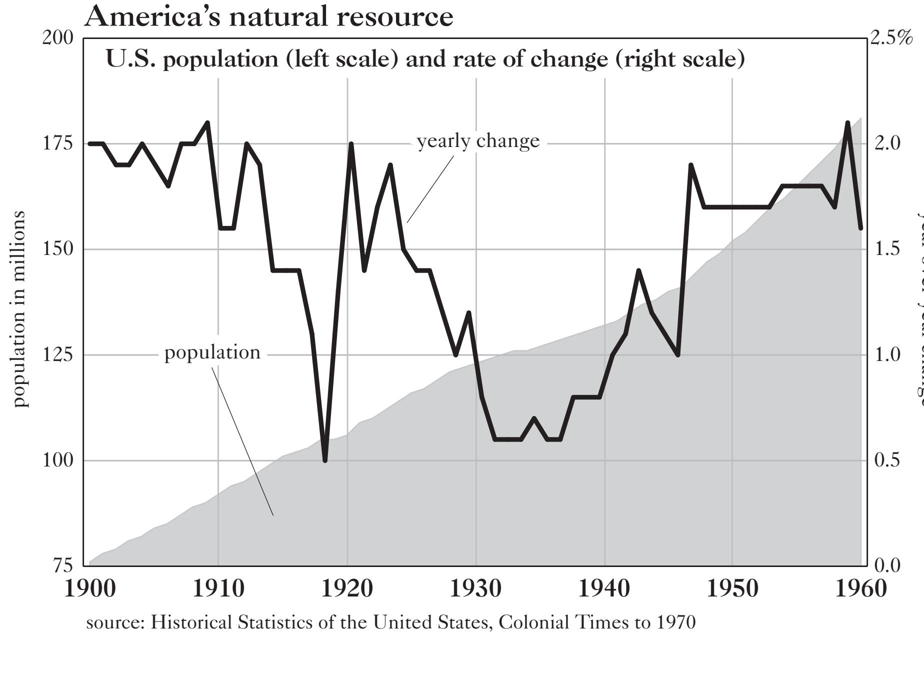
You, Mr. or Ms. *Grant's* Subscriber, may or may not be a landowner, but you assuredly have an interest in the forces that push land values up or down. It happens that the foremost of these influences is the one in which this country enjoys a competitive advantage. Respectable population growth is what America, alone among the world's big economies, is currently registering.

The population of the United States stands at 313 million today. That's Democrats, Republicans and independents, citizens and all others. If United Nations' forecasts are on the beam, our numbers will increase by 26.7 million between 2010 and 2020 and by 92.7 million between 2010 and 2050.

In comparison to the outlook for the other major economies, America is the world capital of fecundity. Thus, say the U.N. demographers, Japan's population will shrink by 0.14% a year to 2020 and by 0.37% between that year and 2030. Europe's will grow by 0.08% til 2020, before declining by 0.04% through 2030. As for Germany, the great white hope of the old Continent, its numbers will shrink by 0.16% a year through 2020 and by 0.19% a year through 2030. China, too, with its one-and-only child policy, is on the demographic skids, with projected 0.34% growth to 2020 and 0.04% a year through 2030 (the former Red China is slated to begin contracting after 2025). Compare and contrast the United States, whose numbers are forecast to grow by 0.83% a year through 2020 and by 0.71% a year through 2030.

One takes these forecasts with a grain of salt, of course. In the late 1930s, Harvard economist Alvin Hansen preached the doctrine of "secular stagnation." America was fresh out of innovation and enterprise, reasoned Hansen, who had no inkling of what lay just over the temporal horizon. Failing massive federal stimulus, the professor insisted—they called him "the American Keynes"—the economy would stand stock still. Population growth had dwindled in the 1930s to a rate of 0.7% a year from 1.5% in the roaring 1920s. But then came the postwar prosperity and the storied reacceleration in American births. Between 1946 and 1960, America's population

**America's natural resource**




source: Historical Statistics of the United States, Colonial Times to 1970 grew at a compound annual rate of 1.8%. It out-roared the 1920s.

Though the future is forever a closed book, we can guess. To forecast the number of 15- and 20-year-olds a decade hence, count the number of five- and 10-year-olds today. "The birth rate and net immigration numbers will be what they will be," observes Evan Lorenz, the in-house demographer. "Prospective parents are more likely to bring new life into the world in a time of economic growth than otherwise. Foreign workers are more likely to emigrate when there are jobs. If the 1.5% rate of population growth in the 1920s had been sustained through the bleak 1930s, there would have been 7.9% more Americans in 1940 than the Census Bureau actually counted. So we can predict the number of 20-year-olds in 2030 with a small margin of error—a margin that increases as we try to forecast the number of 15-year-olds."

The more economically sensitive figure to know is the number of 15- to 64-year-olds. Without working-age people, after all, there can be no work, as Japan is coming to understand. Owing to a relatively old population (median age in 2010 was almost 45 years) and a small cohort of the very young, the number of employable Japanese is expected to decline even faster than the Japanese population as a whole. "Assuming," as Bank of Japan Governor Masaaki Shirakawa addressed an audience of business leaders in Nagoya late last year, "that labor market participation by the elderly and female population remains unchanged, based on long-term projections of demographic trends, the rate of decline in the number of workers will accelerate further to 0.6% in the 2010s and 1.3% in the 2030s.... Assuming that productivity growth is around the average of the last 20 years, that is, around 1%, the annual rate of economic growth for the 2010s onward will ultimately remain between 0.0% and 0.5% on average and enter negative territory in the 2030s." The central banker was likely not surprised at the news that Japanese office rents fell by 3.7% last year to the lowest level since at least 1990.

Though demographics are not to be confused with destiny, we can apply the Shirakawa model to countries outside Japan. Thus, in the decade to 2020, America's working-age population is expected to grow by 0.4% a year, Germany's to contract by 0.5% a year. Within the limitations of the Shirakawa approach, America would therefore generate real growth of 1.31% a year, less than half the 2.7% registered from 1980 through 2011. Yet even this snail's pace of progress would be more than double the 0.45% real growth toward which Germany would be demographically pointed.

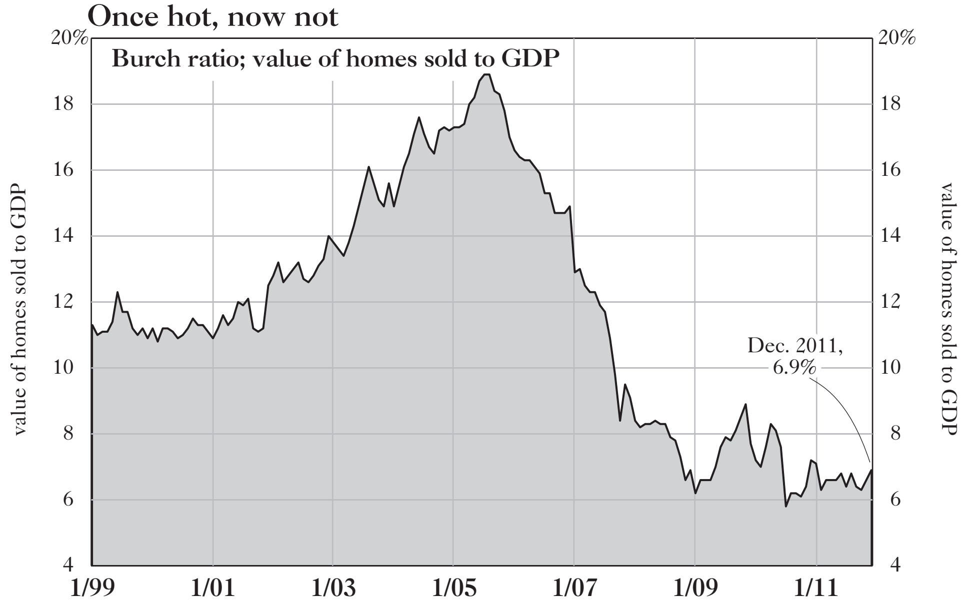
People need roofs over their heads, and America has roofs to spare, of course. By overproducing and over-financing houses in the early and mid-2000s, this country created its own Hansen-like stagnation. However, we Americans have not forgotten the art of baby making. Thus empowered, we are collectively setting in motion one of the solutions to the crisis of the redundant roofs.

The estimated overhang of unsold houses in the 50 states today stands very roughly at 4.1 million. This includes dwelling places listed for sale, in foreclosure and otherwise held off the market by hopeful, or undercapitalized, creditors. It is a big and worrying number. However, it equals 92% of the projected growth in the number of working-age Americans in the next five years. Though procreation represents no certain fix for the housing problem, it may prove more potent than quantitative easing.

It would be nice to know the starting date of the next broad-based upturn in residential real estate (just the year would do). Naturally, to the would-be buyer of a negative-carry asset, sooner is better. Not knowing when, the prudent investor must seek a margin of safety. For Avanti Properties Group, the Winter Park (Fla.)-based investor in land that someone may want to build on some day, the critical source of safety is the price it pays.

When we last checked in with Avanti—CEO Marvin Shapiro and co-chairman Charles Schwartz—it was November 2009 and the world was dark. For the speculative purchase of surplus land, there was no capital and no interest. Of the $491.2 billion of construction and development loans on the balance sheets of FDIC-insured banks, fully $74 billion, or 15%, were noncurrent. By Shapiro's and Schwartz's reckoning, it had been eight years since the American residential real estate market slipped its moorings, 2001 being the year when the growth paths of house prices and household income began to diverge. The price trend, with a friendly assist from the Federal Reserve, proceeded to lurch to the upside. This was, however, yesterday's news, as house prices and incomes had finally begun to reconnect. "Now," said Shapiro two years ago, "in most locations we are in—Florida, California, Arizona, Nevada, Atlanta and a couple of others—I think housing prices have gone below the rational levels."

**Once hot, now not**




source: The Bloomberg

And today? Because some hedge funds view raw land as a winsome alternative asset, Avanti has seen some unwanted competition. Nonperforming C&D loans nowadays foot to $37.1 billion, or 14.6% of total C&D loans (measured progress there). And houses—so this publication believes—have become one of the commanding investment bargains in America. We cite in support of this contention the Burch Ratio, a calculation devised in the bubble year 2005 by reader R. King Burch. Multiply house sales by the average house price and divide by GDP. Behold: a handy reading of the temperature of the housing market. Needless to say—you can just look at the graph—the overheated market of the mid-2000s has turned into the recently ice-cold, now-thawing market of 2012. Burch himself, let us hasten to add, draws no bullish conclusion from his own construct. "I no longer have a finger on the pulse of the real estate market," he writes, "but my presumption is that there is still much inventory yet to be foreclosed. . . ."

"[I]t is," the December 2011 Avanti Properties Group newsletter avers, "always darkest before the dawn. And beginning with a few glimmers in 2010, some noteworthy signs of growth emerged this year. For example, in housing, mortgage delinquencies are declining from their high levels of 2007 through 2009 and are now falling rapidly across the country. Mortgage rates remain historically low. New-home inventory is at its lowest level in four decades. While high rates of foreclosures may cause further price declines, they are not adding to supply. . . . Against this backdrop of historic affordability and minimal supply, the seeds of renewed demand are sprouting because America's population continues to grow."

Much has changed since 2009, but some things have remained the same. For instance, according to Shapiro and Schwartz, banks are still reluctant to liquidate land, or the nonperforming loans secured by land, at realistic bear-market prices. In part for that reason, they investigate much more than they invest. Even in 2009, they said "yes" to no more than one deal in 250, and the hit rate is even lower today.

Founded in 1992, Avanti had generated an average net return of 10.3% in seven partnerships through November 2009. We quoted the officers then as saying that, thanks to the opportunities afforded by the bear market, future returns would likely be higher. They sound more bullish today. Low prices alone augur good things, but the bear market has bestowed other gifts, including a better grade of asset. In normal times, says Shapiro, a value-conscious land buyer would have to settle for property on the edge of development, waiting for the flood tide of growth to wash up on his boundaries. However, in these abnormal times, he continues, Avanti has been able to buy semi-finished lots in the very midst of development—"infill opportunities," or "interrupted developments," as he calls them.

Fieldstone, a 260-acre residential development in Fort Bend County, west of Houston, was interrupted by the bankruptcy of Kimball Hill Homes, its progenitor, in April 2008. Avanti picked up the property, comprising, among other things, 191 finished lots, 938 future lots and an "amenity center," for $14.5 million late in 2010. Included in the purchase were $12 million in bond receivables under a municipal utility district program. While Kimball bore the expense, Avanti will reap the windfall as houses are built on the finished lots. Those lots will bring in $6 million, Shapiro said (about 100 have been sold already). Add in the $12 million of bond proceeds and another $25 million in projected sales of 938 future lots, net of costs—all told, a $43 million payoff, if all goes according to plan, on an investment of $14.5 million.

With an assumed holding period of up to a decade, Avanti is the very epitome of the low-frequency investor. As bullish as the tone of their brochure copy might be, the CEO and co-chairman talk as if they have made terms with this banged-up world as it is. For instance, they say they are counting on a rate of new-home construction no better than two-thirds of the bubble-era rate. "[W]e think that happens somewhere between 2013 and 2015," says Shapiro. "Then, of course, you have a lot of time for properties to absorb from there. Most of our properties, we think, mature three to 10 years from now—the ones that we are underwriting today."

We asked what kind of price-per-acre Avanti was willing to pay.

Hard to say, Shapiro replied, every piece of ground being a little different. But take the case of a house on a lot in a generic sun-belt location. The house would sell for $200,000. The raw, unimproved ground underneath the house would fetch $15,000; the improved lot—improvements being necessary—would be worth $40,000. He said that Avanti would pay no more than $5,000 for that piece of unimproved ground. At the unheavenly peak in fake values, Shapiro recollects, the house would have sold for $250,000 to $275,000 and the unimproved ground for $30,000. So there has been progress, after all, in these past post-bubble years.

Finally, say Shapiro and Schwartz, not the least fetching aspect of the raw land market is its inefficiency. Information is not universally disseminated (neither is judgment). Yes, there's a certain amount of irksome, price-insensitive competition in the residential side of the business but next to none in the nonresidential side.

Avanti uses little or no leverage, and we asked if that was a result of a hard-learned lesson or rather from the hard-wiring of their own brains.

"We try to learn most of our lessons from watching our competition," Schwartz replied.

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