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Terra frisky

"We have tried to look carefully at whether or not broad classes of asset prices suggest bubble-like activity," said Janet Yellen in testimony before the House of Representatives last week. "I've not seen that in stocks, generally speaking. Land prices, I would say, suggest a greater degree of overvaluation."

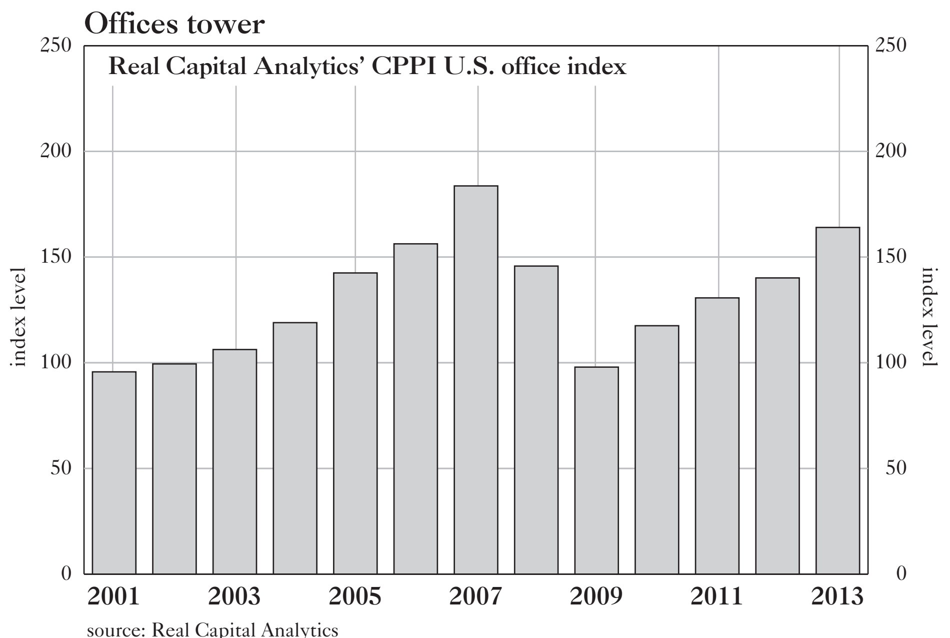
Taking our cue from the new chair of the Federal Reserve Board, we now shine a light on land, specifically on the kind of land that grows houses, apartment buildings and shopping malls. In preview, we don't yet see the overvaluation that Yellen sees, though we do see the potential for it. The Fed's tiny interest rates are putting a spring in the step of the land barons, both actual and aspirational.

Shopping malls are the first, and—to us—most paradoxical item on the agenda. What would you suppose has become of the quoted values of brick-and-mortar retail space since 2010 or 2011, not forgetting the existence of Internet shopping and free shipping to boot? "Mall values have increased substantially over the past three years—more than any other property type—thanks to falling cap rates and rising [net operating income]," Green Street Advisors relates in a new report, "U.S. Mall Outlook." Even with the caveat that "A"-quality properties have captured nearly all of the upside (no bounce for dead malls), any Amazon shopper might be taken aback by the news.

David Peligal of this staff asked Green Street's Cedrik Lachance about the value of the land underneath the stores. "Land values should have risen faster than the underlying property values over the last couple of years," Lachance replied. "And we've seen quite a bit of increase in property values. We believe malls today are worth 20% more than they were at the previous peak in 2007. Embedded in that is the idea that, at the very least, the land is as equally valuable as it was in '07 and might be more valuable."

People work from home even as they shop from home (sometimes they do both at the same time—who's going to know?). Given the possibilities of telecommuting, what do you suppose became of the value of the average American office building—particularly in central business districts—in 2013? Up by 17%, according to Real Capital Analytics, which puts their value only 11% below the pre-crisis peak. A Feb. 7 bulletin in the *Indianapolis Star* frames the bearish case for office towers in this day of shrinkage in the number of square feet of office space allocated per employee (down to 170 square feet in 2013 from 225 square feet in 2010, according to a study by CoreNet Global). From the *Star*: "Andrew Martin, an office real estate broker with Cassidy Turley, said the vacancy rate of buildings with open floor plans is down to 8.5% [in downtown Indianapolis]. But including traditional office spaces, much of which is in Indy's high rises, the overall rate is 20.3%."

Hemmed in at work, people may want space to spread their wings at home. How fares the market in fin-



source: Real Capital Analytics

ished residential lots? There are, in fact, two such markets, the CEO of Avanti Properties Group, Marvin Shapiro, advises Peligal. The user market is the one in which the Toll Brothers of the world transact; the investment market is the one in which the Avantis of the world operate. The former towers over the latter, as the latter is forever capital-deprived. "It's not people's business, generally, to buy and hold land," Shapiro explains, "which is why we've made it our exclusive business niche for over 30 years. There are short, frenzied periods during which this land investment market becomes competitive, like during the boom when home builders bought well ahead of their needs (a symbol for us to exit), but generally speaking, it's the least crowded segment of the real estate market.

"I'll give you an interesting example that shows the distinction between these two sectors of the land market," Shapiro goes on. "Let's take Houston, which is a market quite well along in terms of recovery. Builders are very actively delivering homes close to levels experienced during the peak. The economy has diversified and is growing strong, confidence is relatively high, home prices are on the rise and there is very significant demand in areas that provide access to employment and proximity to good schools and other amenities. We have an asset there that we've talked about before called Fieldstone, in west Houston, which we acquired out of a builder bankruptcy at the end of 2010. We are selling lots in there at a very healthy rate to four national homebuilders—probably between 150 and 200 sales per year. And the prices we're getting are increasing by 8% to 9% a year. We started selling lots in the high $20,000 range per lot, and now we're averaging in the mid-$30,000 range and gaining. If you equate those lot sales on an acreage basis, it's about equivalent to $140,000 per acre, based on four lots per acre. In contrast, in the land investment market, we just acquired a 1,200-lot site in southwest Houston called Stone Creek for $25,000 per acre. Granted, Stone Creek will take longer and will probably require up to $30,000 per acre to create lots, but that still demonstrates the arbitrage that exists between the user and investment market."

Peligal observes that the "arbitrage" may not be so easy as it appears. Last year, Avanti looked at 1,500 proposed transactions. It did only six. Whatever a rip-roaring, indiscriminate bull market might be, this doesn't seem to be it.

A postscript: In disclosing, on Feb. 5, the completion of its acquisition of the homebuilding operations of Shapell Industries, the Toll Brothers' chief executive, Douglas C. Yearley Jr., gave a shout-out to the men and women who helped to make it possible. "We would like to express our appreciation to our banks for their tremendous support," Yearley remarked. "Our new five-year, floating-rate term loan is at a rate currently below 2% with covenants substantially similar to our existing $1.035 billion five-year and new $500 million 364-day revolving credit facilities."

It seems ungracious not to thank Yellen, too.

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