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Balkanization of real estate: Smaller pieces, lower prices, lower risk

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Imagine a time when you book a venue for a two hour cocktail party before the Metropolitan Opera or a three hour slot afterwards for a late night dinner. It certainly could be a restaurant, a hotel or even a country club...not that hard to imagine. But, what if I told you, it's the penthouse of an upper west side New York building that's being rented out in increments of hours or days. It's actually happening under an internet based platform called Airbnb, whereby entrepreneurs are master leasing apartments on an annual basis and subleasing them in increments as small as a few hours. Maybe you've stayed in one.

An article on this activity got me thinking about the decentralization or "balkanization" of real estate. There is a never ending search to figure out ways to take large blocks of assets, break them down into smaller pieces, and sell or rent them. This is not a new phenomenon, but it has certainly been advanced due to internet/mobile technology, communications, and large data bases. Historically, examples abound - from political candidate marketing to "crowd source" funding for small companies. Venues span over political, financial and social arenas, and activities range from sharing news, opinions, planes, cars and of course real estate. Essentially, it is an age old concept of marketplace, whereby people with assets seek to create markets to move them from wholesale to retail, both for profit and for reducing risk of ownership.

Aside from ancient marketplaces, one of the relatively new and relevant aspects of this is the stock market. Started in Venice Italy in the 1300's, but better known to us as the NYSE in 1800, entrepreneurs figured out a model to turn wholly owned private companies into companies owned by individuals, in smaller pieces. This not only provided a new means of building wealth for the common man, but also a way for companies to raise money and share the risk, as well as the profits, of innovation. It was one of the best and early examples of decentralization. This of course has morphed over the decades into instruments like ETFs, whereby stocks of similar companies are grouped together to form new stocks, or mutual funds of diverse stocks are grouped to provide diversity and access to ownership.

Related to real estate, one of the best examples of decentralization is that of loans. Back in the day, real estate loans were typically made to individuals with personal recourse if debt was not paid. Starting in 1970, the U.S. Department of Housing and Urban Development created financial instruments whereby loans were securitized, that is, made into smaller pieces to sell to individuals in the financial marketplace. The common man could now enjoy a small role as banker, profiting from a reasonable interest rate, and the original or primary lender could decentralize its risk. Securitization was often accompanied by "tranche lending," whereby pieces of loans were commoditized, rated for security, and sold to various investor groups or banks, depending upon their appetite for risk.

On a somewhat parallel track, residential real estate "balkanization" was moving from buildings like hotels, an obvious historical example short term lodging, to cooperatives, condominiums, point shares and time shares. These were all great entrepreneurial ideas to create real estate in smaller portions, with more flexibility of ownership and use, for less cost to the consumer...and of course providing more profit to the entrepreneurial creator. Alongside of this came Real Estate Investment Trusts which allowed individuals to own pieces of properties, typically grouped by similarity of use, and managed by competent professionals. A recent update of this is a REIT for an individual building.

Real estate is also in the process of moving more towards concepts of office sharing, flex space, versatile open floor plans, in some cases "virtual office." Technology is helping innovation in changing older real estate paradigms into more decentralized concepts, whereby entrepreneurial individuals can enter into, and influence, the marketplace from small startup companies, financed by small startup investors, with small communication instruments such as smart phones and tablets. Where this leads to, one can only imagine. It will certainly meet road blocks, ranging from union taxi drivers (think Uber) to rental contracts prohibiting subleasing, to financial contracts limiting loan selling, to plain old cultural resistance. Despite those obstacles, one thing I know from experience is, it will continue to amaze us, and provide opportunities to entrepreneurs as well as consumers, and thus is a tsunami which will not be stopped.

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