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Common sense in 2019 - by Bill Pastuszek

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This article was originally written in 2015. Seems like a long time ago. Interestingly how everything changes there are some fundamental concepts that don’t.

A lot of economic behavior takes place based on a lack of knowledge and judgment and over-reliance on habit, benchmarks, or other factors founded in laziness or incompetence. Real estate behavior is no exception.

Technology and human nature makes for a potent combination in producing illogical and incorrect results. Feed enough data into a program and something is bound to result to make sense to somebody.

Somewhat like walking around outdoors but using the iPhone to tell what the weather is. Real estate markets are dynamic and changes are subtle, slow to change, and changes often are not immediately apparent. The foundation of more than one real estate bust has been built on accepting input from machines and ignoring obvious signs on the street.

Investment real estate markets are long term. Assets lack the immediate liquidity that is available in the stock and bond markets. While that may be a good thing, it also means that investments should not be entered lightly; getting in is easier than getting out, most of the time.

Given relatively long horizons of real estate, it’s easy to interpret short term signals as definitively and definitely indicative of the future. And beware of the insidious effects of seemingly small compounding resulting in large future outcomes over long investment analysis holding periods. The future doesn’t always work out as modeled: a rosy today doesn’t guarantee blues skies forever.

The best investors seem to be those who understand the asset, its quality, and location and who are willing to pay a fair price. Once the decision is made, the crowds of analyst can punch up the appropriate scenarios.

It’s the less sound investments that require great motivation to buy and to justify prices being paid. Currently, investors decry the lack of quality investment alternatives and then use this shortage to justify paying first class prices for second rate assets.

In this low return era, commercial real estate represents the opportunity to make outsized profits. But, having made decisions to invest, there are a lot of moving pieces, plenty of places for things to go awry. Good investors turn down far more deals than they accept.

Low rates – whether cap rates or interest rates or discount rates - have been with us for a long time. There still are some fantastically wide swings between the highest quality markets and those of lesser quality. Investors are focused more than ever in trying to find the fine line between prudent, acceptable risk and imprudent, unacceptable risk. At one end, something like sustainable value and returns results; at the other end, value become volatile and results become uncertain. What seemed like a good idea won’t look so good in retrospect further on down the road. The good times won’t last forever.

Much optimism abounds in real estate and the economy. We are well into an unprecedented real estate expansion cycle and everyone worries, “Is it over yet?” There are plenty of arguments in terms of the health and direction of the overall economy to predict recession or further expansion. There is plenty of blame to be spread around for those who don’t act correctly and those who don’t act at all.

Think about the current rate environment. What do zero or negative rates mean for the economies and real estate. Projections that are not firmly grounded in the thought processes of today’s investors may ultimately cause damage further down the road.

Common sense should rule. Caution is necessary in these volatile and not entirely rational times. Investors and markets don’t like uncertainly and will act accordingly in its face.

Beware mountains of data and the siren songs of pundits. Go outside. See for yourself what the weather looks like. Do some research. Go back outside and think about it some more. Then look at the iPhone. Then act.

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