



THE INVESTIGATIVE INVESTOR

VOLUME 2 • ISSUE 1

NOVEMBER 2008

There is No (Pending) Real Estate Crisis, You Idiot!

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I believe the smartest people knew what was going on. But as long as the champagne was flowing, no one wanted to clog the fountain.

I'm staring at a computer screen, watching the financial markets collapse. Treasury Secretary Hank Paulson has just announced changes to the so-called \$750 billion bailout. Suddenly the finance world seems like a Brueghel painting littered with mangled stock tickers instead of morbid souls—or both.

No doubt we'll soon be bombarded by high-brow books on the current crisis chronicling loose monetary policy, ignorant, overreaching borrowers, the broad use of complex derivatives that appeared to protect against potential loss, the orgy of greed and the suspension of disbelief. Those explanations are valid. But I'll offer another: The failure to ask basic questions.

Let's flash back to early 2005—a period we now know as the height of the great real estate bubble. I found myself alternating between being majorly ticked off and second guessing myself. I was in a room full of VSPs (Very Smart People). These were magazine editors and writers, some with advanced economic degrees, years of finance experience that included living through the 1970s recession, the 1987 crash, the NASDAQ bust. The finance magazine where I was on staff at the time was holding one of its “cover story meetings.” These were intense sessions not unlike the “Gong Show” in which a writer or editor would try to sell an idea. I was there to sell a story on the craziness in the real estate market which seemed to be unfolding before us. I was gonged.

I'd done my advance work. I'd had a long discussion with Yale University finance professor Robert Schiller—a real estate expert who'd called the tech crash. I'd talked with other real estate pros (most cheerleaders, of course, but a few contrarians). I'd studied industry reports which usually showed positive housing trends. Yet most key, I had personal experience buying and selling property with my husband on Kiawah Island, South Carolina, for several years. Our modus operandi: We would buy a property—typically a choice piece of land—with the intent of selling it within a year or two. We chose interest-only loans—an appropriate decision in light of rapidly rising real estate values combined with our short-term approach. We ended up doing pretty well with this strategy, and we never attributed brains to a bull market.

But dealing with different banks we saw firsthand the funky loans they were offering. We came across more than a few people who were borrowing far too much money just because they could. Tapping into lines of cheap credit to pay for flat-screen TV's, swimming pools—the zenith of the excess. We also witnessed how the housing market in Charleston, near Kiawah, had exploded practically overnight, with Lennar and other homebuilders rushing in and harvesting humongous homes on once bucolic farmland; how real estate cocktail-party chatter had replaced Internet stock banter; how myriad television home-renovation shows like “Extreme Makeover: Home Edition” were suddenly populating the airwaves. True, these were mere “on the ground” observations. But to me, at least, they signified a strange, new zeitgeist.

So the story I wanted to write, as I calmly explained at the meeting, wasn't a doomsday “the-real-estate-market-is-certain-to-crash” piece. Certainly I didn't have the facts, smarts or clairvoyant

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skills to even approach such a bold conclusion. My intent was to leave readers with one simple question: Where could all this mishegoss possibly lead?

My pitch lasted about three minutes. Then right after, a huge one-sided argument broke out in the conference room. The suggestion that the housing market seemed to be approaching, to borrow a phrase from the recent election, a mere “silly season”, set people off. Editors were practically shouting at me as well as each other: “It’s ridiculous. There’s no such thing as a national housing market!” “Home prices have never fallen around the country at one single time!” “Homeownership is the right of every American!” “Don’t you think Greenspan knows what he’s doing? He’s brilliant!” (“Well, er, not exactly”...I wanted to say, having paid close attention to the Fed chairman’s seeming ignorance on housing.) But I quickly realized a comment like that before this crowd could have sentenced me to figurative water boarding. So after I reiterated that I wasn’t attempting to write a definitive “Death of Equities” type story, I politely sat down and kept my mouth shut while the meeting continued. It was then business as usual: Which CEO should we put on the cover? What’s up with Microsoft?

The article was never to be. I got some good advice a few days later from a young economics editor who clandestinely dropped by my office. He said he understood what I was trying to accomplish, but then said, “Look, you won’t get a big story out of this right now. These senior guys here—they’re thrilled their home values are shooting up. They’re taking out cheap home credit lines. They’re nearing retirement, so they’ll sell really high and buy a less expensive condo somewhere.” His advice: Just write some small stories for a while and be ready to write the big one when the time comes. I wrote two pieces that got buried inside the magazine.

I guess the obvious lesson I took away from this was that even when it’s not cool to question the status quo, if you believe you’re right, you should. (That would be called a “duh” moment.) But the bigger lesson I learned is that when people are minting easy money it’s easy for them to look the other way. In other words, how easy it is to buy the hype or feign ignorance. How is it otherwise possible that the chiefs at Lehman, Bear Stearns, other top financial institutions and funds—weren’t questioning lending practices at banks? How is it feasible that financial brainiacs weren’t questioning the contents of mortgage securities they were purchasing? The securitizations of these mortgages were and still are practically impossible to value. Shouldn’t that have been worrisome in and of itself? And how come the rating agencies were so negligent, or perhaps criminally, complicit? It’s seems utterly implausible that the most sophisticated Wall Streeters didn’t see what was happening. But as long as the champagne was flowing, no one wanted to clog the fountain.

As a successful hedge fund manager told me recently, “Everyone espoused the same jargon...that there had never be a national housing decline so therefore there never would be one.” This manager, after much questioning and old-fashioned, gumshoe research, began to believe that this pearl of real-estate wisdom was bunk. So his firm shorted subprime and made a killing.

That’s why digging deep from the ground up, asking the right questions, and continuing to ask them, even when you’re being beaten down by other people and striving to come up with independent conclusions is more important than ever these days. When Blue Heron Research Partners was created in 2005, we used collective experiences like this to motivate us. We realized we needed to always strive to go beyond common wisdom and opinion. We had learned the hard way to never be afraid to question, no matter how foolish others might think you are.

Look, I’m not claiming to be smarter than anyone else by telling you this story. In fact, at that heated editorial meeting in early 2005, I’m certain most of those writers and editors had depths of knowledge far beyond mine. Yet as we know, the smartest guys in the room can be blind to their surroundings, particularly if they’re holed up in offices espousing (outmoded) economic theory by day, then going home to a cash cow at night.