FSU Real Estate Trends & Networking Conference

FROM OUR FOUNDER

CNL Founder and CEO Jim Seneff commented on current economic challenges and opportunities as part of a real estate trends panel, Nov. 7, at Florida State University. Here are some highlights taken from his remarks.

On the importance of historical perspective

When I started CNL in 1973 there was a dramatic increase in oil prices. We had high unemployment. New York City was about to go bankrupt. The market started to decline in 1973 and bottomed in December of ’74. President Nixon had resigned five months earlier and the Dow had lost 45% of its value. Sounds about like what’s happening right now. It wasn’t a great time to start a company.

In 1978, on our 5th anniversary, the country was in a recession and we were in a period of stagflation. Interest rates were at 10% going to 21%. Anybody remember that? 21% interest rates? Not a great time to celebrate.

In 1983, on our 10th anniversary, the U.S. was in a deep recession. We had world-wide negative GDP growth. Oil prices were collapsing, which was hurting the western states, and the auto industry was having dramatic layoffs. Not a great time to celebrate.

In 1988, on our 15th anniversary, the Dow Jones was recovering from a 45% decline the prior year, 23% in one day. I was on the advisory board of the state pension plan and the state political figures were very concerned because we lost a billion dollars that day in the state retirement plan. Not a great time to celebrate.

In 1993, our 20th anniversary, the Resolution Trust Corporation was in place, same as TARP today, and they were bailing out the savings and loan industry and the Dow Jones had declined 21%. Not a great time to celebrate.

In 1998, our 25th anniversary, Russia defaulted on its debt and a number of developing countries were borrowing money from the International Monetary Fund. The credit markets were locked up. You could not get a bid. I was on the floor of the Solomon Smith Barney trading floor with Jamie Dimon, who is now Chairman and CEO of J.P. Morgan and we were walking around the floor and I’ve never seen so many frightened people. Some of them couldn’t talk because there were no bids world-wide in the bond market. Part of that was the result of

Long-Term Capital Management, a hedge fund that had been taken over by the banks and the New York Fed. Not a great time to celebrate.

In 2003, on our 30th anniversary, the NASDAQ had begun to decline significantly from the bubble of the prior couple years. The Dow Jones had declined 30% in 2001 after the 9/11 terrorist attack, and you can also remember that was the time of WorldCom, Enron and all the other scandals that we had. Not a great time to celebrate.

Now here we are in 2008, our 35th anniversary, and we're experiencing a major credit crisis. The Dow Jones has declined from top to bottom (which was October 10th) 45% and the U.S. Treasury has initiated a $700 billion rescue package for the banking and insurance industry. Not a great time to celebrate.

So why did we celebrate? Because, despite all the challenges of the past 35 years, America has grown and prospered and so have we, and that's something I think we have to remember. This is not a new thing. The guy who wrote Black Swan said "business is not about nice rain, it's about flood or drought" and we forget that.

So what lessons can we learn?

- An historical perspective is valuable.
- Seek to protect the downside and the upside will take care of itself.
- Look for opportunities between logical thought and the prevailing emotion of the day.

History repeats itself

I think there's a parallel between the current market and conditions in the early 1990s. The tax laws in the '80s inflated prices and people who bought at inflated prices had to wait several years for the market to catch up.

I think prices were inflated in '05, '06, '07, this time because of low interest rates and derivatives. If you bought at those inflated prices, you're going to feel the weight of that the next couple years. So I think there are going to be two types of players out there, those with the weight of what they bought in '06 and '07, and those who don't carry the weight of those legacy assets.

The light at the end of the tunnel.

I'm a little more optimistic than perhaps others are. I think that President Bill Clinton was really the beneficiary of dramatic economic stimulus put into place by his predecessor, George Bush (Senior). I think that the stimulation being put in place by George W. Bush, exceeds that previous effort by a factor of three, four, or five. And that's going to have a real positive impact on the economy under Obama.

Monetary Policy, Fiscal Policy and now . . . Investment Policy

We've had monetary policy . . .

- Interest rates have dropped from 5% to almost zero).

We've had fiscal policy . . .

- Stimulus package

And now, with TARP, we have something new, what I would call Investment Policy, with the government making direct, short-term investments in businesses. I think that piece is going to have a big impact.

On "Mark-to-market" accounting

I think that if we had mark-to-market in 1990, the banking system would have gone away. We're lucky it didn't go away this time because of the interventions they've made. Liquid markets create premiums and discounts, liquidity premiums and liquidity discounts and it seems irrational to me when you have a liquidity discount in place that you have to value long-term assets that way. Now I think there's some balance between the two, but I think we've gone too far in the other direction and mark-to-market is, in fact, part of the problem. I think it has really made the current situation worse.

Real risk versus theoretical risk.

A lot of people have defined risk as whatever their computer tells them is the worst case scenario. The worst case scenario has gone way beyond what they imagined (Take AIG and their CMBSs). They did not have a margin of safety. Most people have not run their businesses based on what could go wrong. They have assumed that the worst that could go wrong was what their computers told them.

The “R” word versus the “D” word.

The longest bear market other than the Depression was 18 months, so we’re about 13 months into this and my view would be that the stock market is going to bottom, if it hasn’t bottomed already, at 840 in the S & P and 7700 in the Dow and it’s going to project six months ahead.

So you’re going to have some down days here somewhere, in my view, between this quarter and next quarter. I think you’re going to have a lot of bad news in the midst of that bottom. But one of the things I’ve learned is the stock market is ruthless about punishing people who have excessive optimism or pessimism or leverage.

Two years ago, we had excessive optimism and people got hammered and even recently with oil, when oil was at $147 everyone said it’s going to $200-$250 and now it’s at $60. I think right now we have excessive pessimism. If you have excessive leverage, pessimism or optimism the market will find you and make you pay for it.

Railroad versus roller coaster.

Most people have the mental model of business, that it’s a roller coaster and everything is either great or it’s bad. A better model, I think, is a railroad track. A railroad track has two parallel rails. On one rail you have opportunities and on the other you have obstacles—at the same time, all the time. We tend to forget that. We obsess about opportunities when things are great and we obsess about obstacles when things are not great. Right now there are tremendous opportunities, but most people are so obsessed with the obstacles that they can’t see the good.

Lessons learned

I think the single most important thing we can learn from all this is that, in many ways, this has been about misallocation of assets. At our company we divide our business between operations and asset allocation. We have operational people and we have different people who work full-time on asset allocation. Asset allocation says that if you’re earning 15% a year, every five years you reinvest all the capital you’ve ever produced in the entire history of your company. So, starting here at the end of this 35 year period, five years from now, we will have reinvested all the capital we generated in the first 35 years. That’s a huge decision to make that a lot of people spend much time thinking about, and a lot of people misallocated it when real estate prices were very high. They made allocation decisions to buy assets that were inflated in value and now they’re carrying the weight of that. So I think the discipline of recognizing there are two things in your business that you are doing—asset allocation and operations—and you need to spend a lot of time on asset allocation because ultimately that's what gets you through these kinds of difficult periods. Operations will be consistent and help you all along but asset allocation can help protect you in the long run.

Advice

Read.

We live in a very complex world and the only way you can deal with this and get your arms around it is to read everything you can get your hands on, so that you can take this complexity and put together mental models that allow you to succeed in life. If you're going to get a job, don't worry about what you make, worry about what you'll learn, because ultimately what you learn is going to be what really makes you valuable in the workplace.