

# the inevitability of the property crash

by Carlos Moedas



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**I**n 2006 Tishman Speyer and Blackrock Realty bought the Peter Cooper Village and Stuyvesant Town development in Manhattan from MetLife Insurance Company for over \$5.4 billion. The complex is amazingly big, with more than 80 acres from 14<sup>th</sup> Street to 23<sup>rd</sup> Street and was built after the second world war by MetLife.

I remember reading about this deal on one of my trips to Boston and thinking that something was wrong. Not that I was a visionary, but there were rumors that Tishman was only investing \$112 million in equity, which represented a mere 2 percent of the total purchase price. The price seemed to include part of the potential upside if controlled rents could be turned into market rents.

That was strange, but when the people closing the deal are of the calibre and expertise of Rob and Jerry Speyer, I just thought they knew what they were doing!

By the end of January 2010 the property was worth less than \$1.8 billion and Tishman decided to return it to its creditors.

However, we should stress that Tishman earned more than \$10 million in management fees since the acquisition of the property! If the value of a property is the discounted-cashflows of its rents, then the \$1.8 billion represents the 'true' value of the current rents going forward, discounted back to the present and we can assume that the \$5.4 billion paid at the time had embedded a \$3.6 billion of upside from rents that were supposed to be at market.

This deal illustrates better than any other the real-estate bust and its inevitability: 'the bigger



Stuyvesant Town

the better', 'credit no problem' and 'pay for the upside today'. The amazingly easy availability of credit gave investors the wrong incentives to pay for 'virtual' upsides and increased their appetites for bigger deals.

Bigger deals meant bigger transaction and management fees, which by itself could justify paying part of the upside today and forgetting the main rule of real-estate i.e. the upside is for the one who creates it, not for the one who sees it. Furthermore, as we say in Portugal, if you owe a little money to the bank—you are in trouble, if you owe big money to the bank—the bank is in trouble.

The sad part of this story is exactly that: an entity like Tishman can just walk away from such a big deal while the man on the street would be in trouble for life for a much smaller amount. This is clearly unfair and the financial system should learn this lesson for the future. The world is about incentives and even the smartest people make the wrong decisions if the incentives given to them are pointing in the wrong direction. Corporate responsibility is crucial to fair business practices, whether in property investment or any other sector.