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U.S. Investment

Real-estate crisis... or pension fraud?

by Kathy Burdman

A new sort of real-estate speculation has developed recently, based on the expectation that the boom has ended, and prices are about to decline—drastically.

According to a report issued this week by White House consultant Alan Greenspan, resale values in the $600 billion home mortgage market, which have been zooming for a decade, have now begun to level off, worrying home-owners. In the $1.5 trillion commercial realty market, brokers are raising the fear that the $10 billion in new real estate coming onto the markets during 1981-82 cannot be absorbed.

The rumors of a new real-estate bust reflect only part of the truth. The actual story is that the major institutional investors, led by Prudential Insurance and Citibank, plan a *controlled collapse* of *certain* real-estate prices, in order to restructure their own holdings.

Playing the "greater fool" in this game will become $150 billion in American workers' pension funds, upon which the big institutions want to unload just those elements of the real-estate bubble from which they seek to escape, *EIR* has learned. Lured by investment advisers at Prudential and Citibank, and by private advisers, "pension funds which have had very little experience in real estate are going to be buying in big—just as we're getting out," Robert Ferrari, chief economist at Prudential, told an interviewer this week. "This is going to allow us to get rid of a lot of paper we don't want."

Prudential, Citibank, and the other institutions have another motive: to enable Federal Reserve Chairman Paul Volcker, one of their most valued assets, to continue *to maintain U.S. interest rates at current high levels for the foreseeable future*. High rates have been an efficient means of channeling capital away from consumption industries such as auto, housing, and steel, and into the institutions' preferred speculative investments. But another six months of such rates could blow out real estate along with the rest of the economy unless a new source of capital is found to support the market. The institutions believe the new flow from the pension funds will "produce a whole new boom in real estate," Ferrari said. "Or at least, they give us a sort of insurance. They've put a floor under the commercial real-estate market."

Over the last two years of the Volcker Fed's 20 percent rates, the institutions behind Volcker have succeeded in restructuring U.S. real estate, collapsing the home sector—personal consumption—by 25 percent, and directing funds into commercial realty speculation. "We have been able to use high interest rates to totally restructure the capital markets," Ferrari boasted. "We channeled investment out of housing, and into commercial real estate. America had too much housing, anyway."

By the end of this year, the life-insurance companies will have put some $100 billion into commercial realty, and the major commercial banks over $150 billion. By contrast, they have deserted the home mortgage market. Due to the interest-rate squeeze, however, there are certain sections of the commercial realty market which are now softening, with developers forced to make "front-end" concessions such as free rent to prospective tenants.

It is that segment of commercial real estate the major institutions hope to unload on the pension funds. Until late last year, most union, corporate, and public pension funds had steered clear of real estate as speculative, and at the end of 1980 had only 2 percent of their $600 billion assets, about $12 billion, in realty. The rest was in stocks and bonds.

What happened? "The pensions got clobbered in the bond and stock market by high interest rates," laughs one Chicago investment adviser, "and came to us. We told them to get into real estate, and now they all plan to do it." With so little of pension assets in realty, "they represent a huge new source of investments in commercial realty."

Insurance economists predict that pensions will add some $10 billion to commercial real-estate investment by the end of 1982, and perhaps $150 billion in the next 10 years. The first unions to be suckered in, they predict, will be the AFL-CIO building trades, who seek to encourage jobs in the construction industry. Armco Steel Company's $1 billion pension fund is also interested, hoping to encourage sales of steel to the construction industry.

According to Prudential's Ferrari, the pensions will get the worst deals. "We get the first shot at every real-estate deal that comes along," he said, "and now we can pick and choose. The pensions on the other hand, have very little experience. They'll take what we will not."

As for the home mortgage market, the big institutions are confident that it can be allowed to slowly collapse without triggering a major crisis, and are advising even the pension funds to stay clear. "The fallout in home mortgages doesn't affect commercial realty at all," said Citibank real-estate director James Trucksess. "It's hermetically sealed off, and we're steering clear of it."

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