

VALUE IN NORTHEAST OHIO

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Starting a Newsletter

I've decided to write this newsletter because I think that much of the national news reporting on economics tends to gravitate to the sensational. Sometimes there are well respected sources that are utilized, but their opinions are still somewhat extreme. I will provide my own analysis to certain topics and, at times, show why my opinion may differ from these experts.

For this issue I will be focusing on the housing market and the outlook for it nationally and locally.

I will also opine on a variety of issues that are relevant to Northeast Ohio. I will largely be non-partisan because I do not have strong political party affiliations and may move from one to the next depending on which closer reflects my values on the most pressing

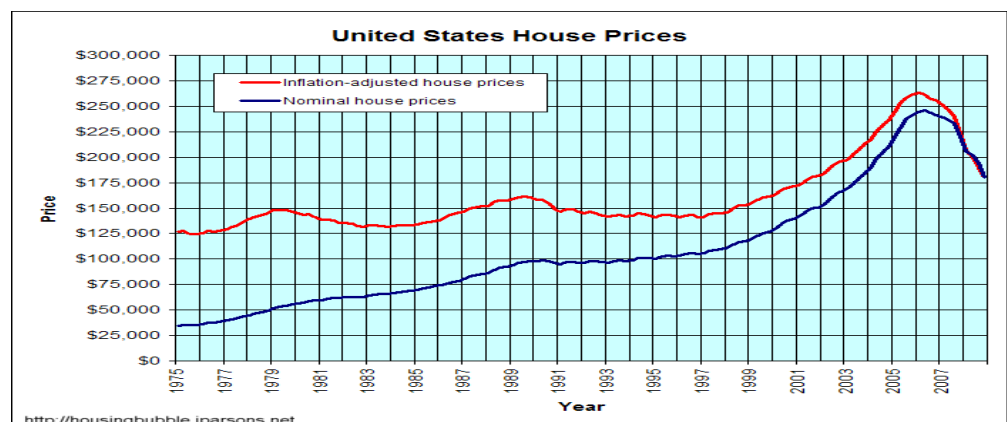
topics. Again most of the topics will be economic in nature. For example in this newsletter I will discuss Shaker Heights' plan to remodel the Chagrin/Warrensville intersection and extend the Blue Line Rapid through it.

I would greatly appreciate your feedback and know if you would like me to continue sending it.

Housing Bubble Bottom?

Housing clearly has been pummeled over the past 3 years. A picture is worth a thousand words, which will save me a lot of typing. (Continued on page 2)

Chart 1



Housing Bubble Bottom?

I expect the national median prices to decline close to \$150,000.

Given that we were at \$180,000 as of the 4Q08 there is about another 15% to get there.

The news is better for Northeast Ohio. Chart 2 below shows the Case Schiller Index for Cleveland in Blue. The red line shows the February '91 index trended at 2 1/2% per year to account for inflation. Why February '91? Because it was the bottom of the last housing cycle before we began bubbling the stock market and housing market.

Beyond the chart there are fundamental reasons to expect that housing here will stop falling. First, Northeast Ohio is no longer the poster child for the foreclosure crisis. Foreclosures have begun to

decline ever so slightly in the last few months.

The blue bars in Chart 3 below show a slowly declining foreclosure trend in Cuyahoga County over the past 12 months. The yellow line shows housing price appreciation, which is nearly flat for they year. This chart was provided by RealtyTrac.

Housing affordability is at all time highs due to the combination of low mortgage rates, currently about 5% for a 30 year mortgage, and the moderated housing prices.

This is not to say that we are at the beginning of a red hot housing market. Chart 1 showed that housing tends to move with inflation over the long term (except during the bubble). We have significant unemployment issues, especially in the automotive and banking sectors, that will strike

this area particularly hard. This will contribute to foreclosures spreading beyond the subprime borrowers.

The inflation outlook is very calm for the next year or two as the recession inhibits demand. Beyond that there is likely to be higher inflation than what has been seen over the past 15 years because of the massive expansion in government spending and indebtedness. At this point it is almost impossible to predict whether the inflation will be 3%, 5% or more. I expect that it will not go much higher than 5% as the central banks' memories of the '70's have not faded enough to allow double digit inflation to return. Purchases made with prices at relatively low levels and with mortgages at today's low rates will probably be considered fortuitous in the years to come.

Chart 2

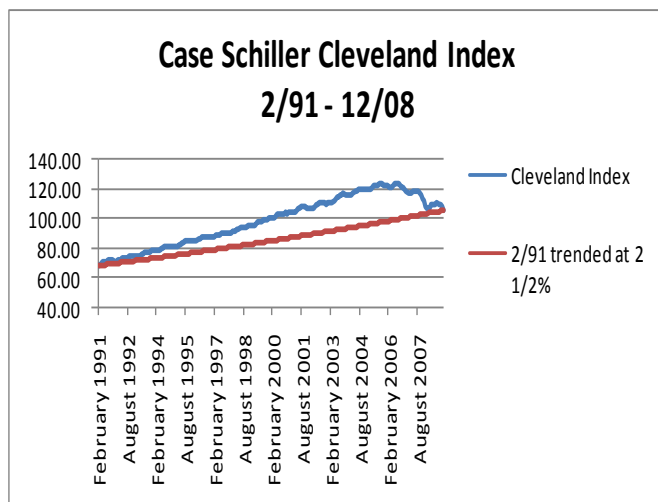
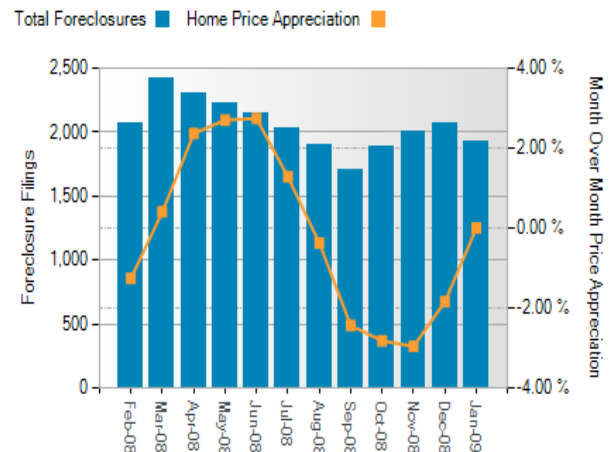


Chart 3



Medical Mart—How Much to Pay for Public Auditorium?

It seems that Cuyahoga County is getting closer to settling on the Mall B/Public Hall location for the Medical Mart. There apparently is significant savings to be realized because the foundation is structurally sound thus saving \$100 million or more in construction costs.

Recently it came to light that one additional cost seems to have been ignored. The site is owned by the City of Cleveland and Mayor Jackson wants compensation. County Commissioner Tim Hagan was taken aback by the notion that the city would expect anything for it given the jobs that would be generated by the project and the related taxes.

The first question is what is the



site worth on a fair market basis? We know that Forest City wanted about \$40 million for their parking lot behind Tower City. It can be argued that the mall has more value because of the reusable foundation and Public Auditorium.

I don't know how much income is generated by the Convention Center or the parking lot under Mall B but I suspect that the income is less than what would be expected from a \$40 million property

as the convention business is not that good now.

The next question is should the city realize full market value? Commissioner Hagan has a legitimate point in that the City will benefit from the project not only creating construction jobs, but operating jobs, and increased hospitality business which will create more jobs and business income and therefore more taxes. If the Mart does what is expected it will help enhance the region's image as a medical technology center and will spawn new businesses.

I expect that a deal will be struck well below fair market value, but not for free.

Blue Line Extension

It was reported in the Sun Press and Plain Dealer that Shaker Heights wants to extend RTA's Blue Line through a redesigned Chagrin/Warrensville Center Road intersection.

The city is retaining a lobbyist in the attempt to get Federal funding. It will cost \$50 million according to the report.

This appears to be the local ver-



sion of the Alaskan "Bridge to Nowhere". The extension is 1/4 mile. My questions include how many additional passengers will ride as a result of this improvement? How much will this impede a very busy intersection when 8 trains per hour chug across during rush hour? Is there another use of \$50 million that will have a bigger impact on the region?

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Bonuses for AIG, FNMA?

The headlines are filled with stories about the enormous bonuses paid to employees of companies bailed out by the Federal Government. Is there any justification for this largess?

AIG is interesting because it has several insurance units that are still valuable money-making enterprises, even if the parent company is not. As 80% owners of the parent it is in the taxpayers' interest to make sure that the values of these companies are maintained. Bonuses paid that are consistent with normal profitable operations

should not be resisted because the high priced talent will leave for other companies that are not constrained in their compensation policies. This would adversely affect the ultimate value received by taxpayers when the companies are ultimately sold.

The Financial Products group, the ones that generated the gigantic losses poses a different dilemma. The group presently has about \$1.6 trillion in contracts to be wound down. A certain core group is required that is familiar and competent to make this hap-

pen. How much compensation is required to do this is another question. I don't expect that derivative trading is as hot a market as it used to be or hopefully ever will be again. The magnitude of some of the bonuses seems beyond reasonable. None of those guys are worth \$3 million +. The AIG brand has little value now so once the derivatives are down to a small enough level these employees can seek work elsewhere.

Herbert Allison, the head of Fannie Mae, defends the paying of large bonuses to his employees.

He claims that they "need to maintain the skills and experience to keep the mortgage market operating."

It's hard to believe that all the senior staff would leave. If what Mr. Allison is true then the number of jobs to leave Fannie Mae will begin to dry up until some kind of new equilibrium is established. I do believe that some people would leave. I also believe that there is a lot of unemployed talent that would fill the void. Bottom line: These are government employees and should be compensated accordingly.