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**IT’S Q2, 2012 FOR REAL ESTATE:**

***SO WHERE’S THE BEEF!?***

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April 1, 2012

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**THE MARKET TODAY*—“DEAD OR ALIVE?”***

Well. Okay. It’s 2012 and there **does**, indeed, appear to be some easing in the real estate and credit markets out there, pretty much right on time and as predicted by this author last year. See archives at [www.eckleylaw.com](http://www.eckleylaw.com) . But also as predicted, it still looks at first blush to be only the kind of post-trauma “economic bodily twitches” that signify “life is present” but with virtually no assurance that the “life sparks” seen signify stability or even that the apparent resurgence is reliable and not a just yet another hope-building but inevitably false blip on the statistical screen. We have seen too many up-ticking blips which increased our pulse rate only to be followed by the next long flat line. The jagged ups and downs on this patient’s chart seemingly swing so wildly from death to life on a daily basis as to give no confidence at all except to the most rash among us—the same ones whose irrational exuberance and subsequent over-valuation and over-spending got us here in the first place! So. Is it Armageddon yet? Despite what the Talking Heads are opining on evening TV, ***that’s not the assessment of the wiser and cooler thinkers working in the more talented management and recovery trenches.*** For the Old Dogs who have “been here before,” the tea leaves seem to bode quite a bit better. A tour through the battlefield by one of those Old Dogs and then a conclusion follows.

**WHERE IS SINGLE FAMILY RESIDENTIAL OWNERSHIP?**

Let’s look closer at the body on the gerney before us: The boldest residential money--single family residential investor money--is still buying the giveaways, but those are running low and it has stopped at the lower pricing third of the market. The investor money is not yet buying at the middle or at the top and the effect of a dwindling inventory has not pushed prices up so much that they trigger a next-higher-tier land rush either by investors or the rest of the marketplace. The first-time owner-occupant buyers are usually in that lower third—the traditional market entry-point—and cannot compete with the speed and liquidity of the investors and are therefore left only with the overpriced market rejects and with the wrecks as their options. They cannot get high enough qualifying appraisals on the over-priced product and they are not buying many of the wrecks, as those are the meat of investor fix-and-flippers, with whom they also cannot compete for the same reasons. Moreover, by usually having to pay “full retail” for their fix-up workman, the Mom and Pop occupier/buyer also cannot make fix-ups pencil out, even if they could find the finance. There are few if any center-market move-up buyers because, for the most part, they are under water on their present homes with their own post-2005 mortgages and the only exit option from those other than paying them off at 150% to 200% of current value is a strategic default, which many are reluctant to chance and which would, in any event, under the law and mortgage practice, disqualify them from buying at all (let alone up) for the foreseeable future, anyway.

The jumbo and super-jumbo markets are stuck in the same position, i.e. move-up buyers for the high-end market usually come from the high-end middle market and those buyers are struck in their own under-water high-middle market mortgages as noted, above. Add to this that the top end also has its share of underwater mortgages that are in excess of value and that it also suffers from loan appraisals that are now positively draconian in their miserliness and you have three-quarters of the potential single family marketplace that is still so mired in the illnesses of yesteryear and so abandoned by the low-end-focused “recovery programs” today that it cannot get well. It’s a debt-bogged market that cannot even dig itself out unless by the twin loan defaults of both listing seller and move-up buyer, “alternatives” which virtually assure that neither will have much credit to consummate either that sale or any other purchase thereafter.

The fact is that a large number of owners who are underwater on their mortgages and who would be good sellers and buyers and who do have money and something to lose if their credit was destroyed by a short-sale are beached by this market. They lose money they do have by staying in their homes but cannot rationalize taking the mortgage-over-sale-price pay-down hit to conventionally sell in order to conventionally buy and especially to move up. The principals in the top 75% of the marketplace are thus locked in a permanent economic coma and there are no viable recovery programs aimed at curing any of what truly ails them. None present. None on the way. Except to hope for massive inflation—the kind the Feds have sworn they will never let happen again (but will at some point). Hence, the only present option granted this tier thus far is the financial hemorrhage and credit-wrecking amputation of short-sales and foreclosures. Remedies which only assure that the move-ups will never be ambulatory enough to sell their homes or buy anything anytime soon and hat today’s short-seller cannot be tomorrow’s buyer.

**WHERE ARE RESIDENTIAL RENTAL MARKETS?**

The rental market is going Great Guns for the very reasons the single family homebuyer market is not. People are being dispossessed by foreclosure and are becoming more migratory as they move out and as some then seek work elsewhere. They are all, however, common in one need and that is they must have some place to live and the investors are providing it by single family rentals at top cap rates generated not only by this higher historical demand for rental properties but also by the rock-bottom prices they paid to snatch the product from an earlier owner’s distress. Major multifamily purchases are being assembled virtually every day by the larger investors like the REITS and REMICS and this is good for the Big Boys and likely to continue as long as there is no product for entry-level buyers to buy (as noted above) and so long as the only option for the middle and above market of sellers is to remain entrapped where they are, left only with the option of using their savings to fund their over-cranked mortgages until they give up or go bust and go ultimately into foreclosure, or to bail now and rent or to ignore purchasing altogether and just rent. These trends will pencil very well for investors for many years. Those who bought earlier and deep enough will get the twin returns of a great current cap rate and then, later, as the economy upticks and tenants see that purchasing is once again more viable than renting (and time has cured their bad credit), they will sell for significant and at that point probably genuine appreciation (and not just the “fictitious profits” of inflation—thought that will come later if they wait too long to sell).

As a socioeconomic “aside” here: This divestment tragically means that the exuberant health of investors in the rental markets is the result of a vampire-like feeding on the death of the single family ownership, which, for the first time since WWII, has actually contracted by millions of units. It is a scenario that does not look like a promising return to a previously healthy status-quo for Americans and housing ownership as much as it looks like an economic holocaust for one of the principal promises of America for the last 300 years—the ability to buy and own a home. Rentals and neighborhood conversions from ownership to tenancy risk displacing large blocks of Americans, creating and segregating economic classes, reversing the economics of vast segments of realty and if sustained can consequently dismantle and alter the sociology of communities, nationwide, in ways no one can begin to imagine, but surely into ones that are a far cry from “the Traditional American Way”. It is likely that any trend increasing and “transientising” the “Have Nots” by an enrichment of the absentee “Haves” simply cannot be deemed “good health”. Economic predation does not rebuild. Instead, at some breaking point, it usually generates a horrific public backlash.

But enough on these less-pleasant sociopolitical side points. As a pure economic matter, capitalists would be quick to point out that this cannibalization process proves that the laws of supply and demand work and that a robust investment rental market is still a market that helps the real estate economy revive and that, indeed, it does serve the needs of the moment of both landlord and tenant.

**WHERE ARE INDUSTRIAL AND MANUFACTURING PROPERTIES?**

Industrial and manufacturing properties are languishing across the board, with the exception of the “just-in-time” ambient and temperature-controlled warehousing properties and systems that are popping up near arterial points confluent in motor, rail and air, to freight third-party inventories and supplies. These core warehousing and shipping systems are making and will continue to make huge gains as retailers and end-users reduce on-site supplies and inventories to cut their flooring, insurance, self-freighting and warehousing costs. This is really just massive end-user belt-tightening under a different name and shifts the costs of inventory from manufacturer or retail vendor upstream to the suppliers and distributors. “Just-in-time” confluences are a very strong market at the moment, whether in existing or build-to-suit product, and with the inventory and warehousing cost-shifting backwards from retailer to distributor to manaufacturer going at an increasing pace, expect this area to prosper now and for some time.

Except for pockets of activity such as storage and distribution confluences, the picture is not as good. The industrial segments—which include bare commercial land on which to build them--are driven by manufacturing, manufacturing is driven by consumer consumption and with the user market wobbling, little is being seen in significant expansions, except by those industrial and manufacturing entities which have the funds or credit and the bullishness to use the current austerity and low-cost credit and highly competitive construction cost savings to expand.

**WHERE** **IS COMMERCIAL OFFICE AND RETAIL?**

Quality, major “signature” commercial office and well-anchored, established mixed-use retail is getting some juice from the big (but heavily discounted) buys being made by REITS and REMICS. Those with large (usually securities-generated) pocket books and with the staying power to invest for the longer haul needed to absorb a decade of what will be competitively lower rents (which securities-fueled, all-cash, no financing, 100% equity asset purchases make possible) are having a buyer’s hay day picking up the once-in-a-lifetime jewels left at the curb by The Crash. Anything less than major, multi-anchored retail is taking a bath and will continue to as, one by one, the beached big boxes outdone by the e-purchasing trend either contract or close down entirely and take adjacent, codependent smaller tenants down with them. Some light has been seen in the areas of bundling luxury condos and lofts over or around retail and entertainment “life-style” venues for added residential pricing coupled with a built-in retail constituency for a collective “life style” draw to outsiders, but those assemblies are currently of appeal primarily to a limited, somewhat unique urban community not large enough to influence a broader market. Other mixed use projects caught mid-way when The Crash hit have for the most part failed and have been either abandoned or liquidated into more mundane uses. These failed “A” projects—often with all the P & Z and legal done, are a great scoop-up buy for the vultures to finish more modestly as highly viable “B “projects. Again, REIT and REMIC money or a large war chest of retained, undistributed corporate treasury money or AAA-rated creditworthiness comes in handy there. Some have it and a lot do not. Even for those that have it—and that is a large group right now due to a bearish hoarding of corporate cash during the last few years--may not be in a bull posture right now and will “take a pass” on these scoops only to regret it later. Even after having identified these rays of sunshine, though, the long and short of it is that they are anecdotal and not a flood. The bloodbath in low and medium market office and retail is far from over and it is there that revival is needed most as sites of decaying centers and windblown “see-throughs” increase across the landscape and do inevitable collateral vicinity damage.

**HOW ABOUT BARE LAND?**

The best buys in bare land now for future positioning are assemblages of all of the old hubbed, platted, P & Z’d, utilitied, streeted residential lot inventory one can find that is reasonably close to civilization. When the music stopped with The Crash, builders abandoned these, repossessing lenders have sat on them and some have been mothballed at tremendous holding costs and up until recently there was no retail or wholesale market for them at all. But there is going to be once the nail guns start popping again and those builders who let their inventory go are going to be desperate for product—and hat time is close or perhaps even on us now as pre-existing lower-end housing inventory disappears or tightens in cost as noted above. As to the completely undeveloped large tracks of bare land Way, Way, Way Out Yonder, miles past the last Trading Outpost and occupied clover-leaf—it’s just not time and for the Smart Money, maybe not for years when there is so much more instant money to be made elsewhere.

**ABOUT CHOSING WISELY:**

The tour through the assets above has contrasted some winners and losers and revealed some “”up-and-comers” to watch, suggesting that the likelihood of survival right now might be the ability to bet well on the yearlings of today rather than on the traditional nags of yesteryear. Strategic thinking in this arena is where one uses his or her head for betting and not his or her glands, like the misguided losers of yesteryear did.

Let’s turn now to more specific ways some have coped with a troubled portfolio or asset and then let’s identify to the “coping-quinella” of 2012 and beyond. Warning: The best solutions discussed below are “R-Rated” for guts, violence and confrontation. Softies should probably stop here.

**THE RECOVERY GAME-PLAN: *TWO TRADITIONAL COPING PARADIGMS***

***For Those Already in a Mess***

*Okay, so you are “in” for guts and violence?! Here we go….*

For those with assets and exposure in the current Dead Zones, there are two basic methods to cope with an eroding asset value or a precarious debt and equity position and ambiguous market direction. One “method”, if passivity can be called that, is that one that sits on their current real estate investments or portfolio, holds steady through seas of red ink, feeds them down to the last dime of resources and waits until The Recovery comes about on its own--as it one day surely will. This “might” be a viable plan if one has enough savings to feed into the black hole of debt service, maintenance and operating loss so that they will last to that unknown date when the plummet stops….and then last for even a good time more thereafter to wait it out as values attempt to rise. That’s a long and risky wait and the use of more and often precious good funds to patch bad holes in old investments is a crapshoot many capable players will not join. The last time we were here (the ‘80’s) that wait between collapse and restoration was about 12-15 years. A 12-15 year feed is usually bad economics. Patients in comas half that time usually get the plug pulled.

Alternatively, one can actively take steps to change their current asset and debt structure now and thus make their own recovery plan happen in a fashion they are in charge of. This “heal thyself” plan is usually more viable, especially if feeding black holes indefinitely is not feasible or even possible and as time wears on with no Big Turnaround. And by “Big Turnaround”, I do not mean just “stop sinking”—I mean active and expeditious pricing up-trends to and attaining at least 90% of pre-Crash value. The “heal thyself” alternative plan is covered more in detail, below.

The fact is that at the moment real, sustained, even recovery is not on the horizon right now and predicting when it will be must be suspected as pure voodoo. But if one wanted to take a whack at it, using the yardstick of the 80’s, if The Crash commenced July 1, 2006, the date now popularly fixed as the high moment in sales and prices after which all boats sunk, the Big Turnaround, getting back to pre-Crash values, might well take until 2018 to 2021. That is assuming no more 9/11s, that Europe does not fold, taxes to feed the deficit and interest rates to compete for funds do not soar and Wall Street does not Tank.

***For Those Not in the Mess or In it But Bold and Ready for “R-Rated” Action***

For those who escaped significant wounding in The Crash and for those who may have been caught in it and injured a bit, but are bold enough, well-funded enough or imaginative enough to solve their losses not by just liquidation but also by making some great counter-balancing buys , this is their moment. Cheap, top-quality product is everywhere and being sold at “never again in this lifetime” prices. The smart crowd is buying it like crazy because they can make it pencil out right now after rock-bottom acquisition costs or because they have the financial staying power to wait for the Big Turnaround, or both. Some who have been wounded see that they can “buy” out of net loss positions by adding product so strategic and now so cheaply that when it blends with the overall portfolio the whole equation becomes net gain even when in the same bin as the pre-held losers. The gain yin from the acquired winners offsets the red-ink yang of the existing losers. That gives the loser assets time to get well and that both sustains the portfolio now and positions the portfolio for the next boom. And that boom will come not only because of other natural economic forces but also because so little new, expanded or replacement product is now being pushed down the pipeline to meet it. There is going to be scarcity of supply to meet pent up demand.

**METHODS TO EFFECT THE APPROACH**

The “active approach” noted above, i.e. refurbishing one’s portfolio for a recovery NOW rather than waiting for it to come on its own later, can be accomplished by “buying” one’s way out, as noted above, but that approach takes cash or credit resources that may not be available. Most have had to approach this by working with what they have, primarily. Turning to that, these have been the usual methods:

1. LOAN MODIFICATIONS: First, some have sought recovery by seeking to modify their debts. This is most common in single family residential settings, but is moving to the forefront of commercial borrowing as well. Modification by permanent principal reductions has been rare as most lenders are not policy-friendly or financially structured to sustain these. Interest rates and term of finance and short all-due date extensions have been the majority of the results. Often it is not enough and only postpones failure.
2. SHORT-SALING: Both the residential and commercial markets have also moved their White Elephants by short-saling. The issues here are typically that short-saling often does little to cure the greater issues, which is the debtor’s loss of the resource coupled with an exposure to the loan repayment short-fall. In some states and with some loans, there is no recourse on identified single or small multiple-unit residential properties under local lending laws. But all states allow for deficiency liability on at least commercial and business loans. Thus in many applications where recourse is going to be had, short-saling is but a gratuitous prelude to the seller’s inevitable bankruptcy when the lender pursues the balance. In that case, it usually makes better sense to stay with the property, negotiate if for nothing more than filibuster, or seek bankruptcy protection which, in some cases, can also radically modify the debt (against the lender’s strident wishes) to be more favorable to the borrower and also keeps the borrower in the asset, perhaps even making it, through cram-down and Section 365 white-knight sales, viable.
3. FORECLOSURE: In non-deficiency situations, the loser asset can be jettisoned by stopping payments, conserving the money, and allowing the asset to go to foreclosure.
4. FIREWALLING: All debtors and portfolios should “firewall” assets from liabilities all of the time, let alone just when trouble lurks. “Firewalling” is assuring that good, viable assets (if there are any) are put into places and behind lawful legal walls where they can their own liabilities can be contained and also where what is inside the entities can be protected against lender attacks. It is also important that these strategies and entities are tuned up and legal and “t”s are crossed to do that before the trouble is immediately at the door or before a lender liability fight is picked. One example: Living trusts for the most part have no protection at all under recent law. They need to be converted. All professionals and all investors should be firewalled at all times, but should particularly seek a legal tune-up to assure things are where they should be right before any of these events.
5. BANKRUPTCY: Some residential and commercial borrowers, whether Moms and Pops or the Big Players, have sought bankruptcy protection either after the above alternatives have failed or as a first-choice preliminary step which promises more to the debtor or portfolio which is earlier and usually cheaper. For the large, property-studded individual Bankruptcies or Commercial Bankruptcies, the Bankruptcy court can be the only place to economically and legally work some needed miracles in rehabilitation. The “How-To’s” is a separate article in itself. See counsel for more. The most important point here is to get to the Bankruptcy attorney for a review earlier rather than later (there is such a thing as “pre-Bankruptcy positioning”) and to remember that it cannot be an option approached only after bleeding out all of the cash as, indeed, it also costs money to engage in a productive Bankruptcy and get a good lawyer, too
6. CREATIVE FINANCE AND TRANSACTIONS: There many methods of creative sales, finance and capital development to invent silk purses where only sows ears grazed before. These would take a separate article to discuss, but some have been in an earlier Newsletter about a few aspects of Alternative Financing. See [www.eckleylaw.com](http://www.eckleylaw.com) and use the search engine for “seller finance”. There are a lot more things to be said about Alternative Financing than owner-carries. See a competent lawyer and broker to learn of them. The new federal JOBS program has worked some massive changes to securities laws that now make it very economical and expeditious or large commercial owners/borrowers to generate sale, buy or loan money on the investor market (syndicate one’s own money source). See a good lawyer on that one.

**COPING PARADIGN *THREE*—“THE ‘POT CALLING THE KETTLE BLACK’ PUSHBACK” – THE “R-RATED” ALTERNATIVE SOLUTION**

There is yet another way to deal with all of this and seek personal or portfolio rehabilitation—whether big or small--and all too little has been said about it, though it, too, is extremely viable—sometimes it is the only viable approach after others fail***. It is the borrower approaching the lender and, rather than asking for dispensations of forbearance primarily on the basis of the lender’s “mercy” (?), instead asserting creditable borrower claims against the lender in Lender Liability law for “trade-off” leverage.*** As the mass of litigation nationally has shown about how we got here, the lender’s hands in The Crash are not clean. The Crash is a product of a lot of what the lenders of the world did wrong, sometimes even criminally wrong, to both the world and to the separate borrowers and investors. There was a time when the lenders felt they were only in the business of generating massive commissions on creating huge bundles of loan products and derivatives—and, right along with the rating agencies—they cared little if those loans was ever likely to be paid. They took a lot of shortcuts and every one of those gives the borrower some rights.

An example of a fatal shortcut that could relieve a borrower of significant liability: Recent statistics suggest that it is a fair guess that at least 50% of the owner-occupied residential loans and real estate investment and acquisition loans made or extended after July 1, 2006 through 2010 had over-exuberant appraisals and a good deal less than just “light-handed” due diligence done by lenders, brokers and loan committees to vet them. When those loans tank today, the lender wants it all from the borrower or guarantor—including the money the lender told the borrower the property was worth above what it was honestly and actually worth (incidentally, this is the same property where that extra money is—it never went anywhere) . They want it from the borrower even when it was their own appraiser that came up with the fantasy values and their own committee that vetted the loan as sound enough to be underwritten as “Class-A” paper. This is a waiting lender liability claim. The borrower can contend that the lender is the cause of the loss, that the borrower relied on the lender’s appraiser in even electing to purchase the property and that the lender has violated its own regulatory rules prohibiting false appraisals and unsafe underwriting practices (there is also a criminal statute or two covering banks lying to borrowers). This can bar or limit collection against both against the borrower and the guarantor, if any, and it often generates a powerful counterclaim by both against the bank (one just needs to raise it before the Bank is closed or it gets barred!). (See the bank closure rule by going to [www.eckleylaw.com](http://www.eckleylaw.com) and entering “closed bank” in the search engine at the site.) A condition like this also allows the borrower to “cram down” the business or commercial asset back to profitability in a Bankruptcy court.

The fact is: One of the best bargaining chips to get modifications done today or to eliminate deficiencies in dealing with an ever-more-intractable lender community is by the using a multi-count counter-claims asserting lender liability and using it as trading stock to settle or reduce these exposures and to reamortize property to make it viable again. “Knock this asset back down to the valuation it should have had if it had not been fraudulently or negligently appraised, reamortize the debt to that lower value, and I will forego my lender liability lawsuit for that and forgive even my massive exemplary damages claim for lender fraud.” It’s a powerful method to adjust a debt structure or asset portfolio back to something viable. And it is, after all, though seemingly “rude” with the lender (if that means anything when livelihood is at stake and when the lender has probably been “ruder”) it is simply enforcing one’s right through an application of the law. In most cases, the lender has been far, far ahead of the borrower in this formula, anyway. Most of them knew years earlier there were mistakes and resultant liability to or defenses for the borrower. They just “neglected to mention it” to the borrower. Now that IS “rude!”

**A STITCH IN TIME…..**

Every asset holder and borrower out there ought to engage competent experts to audit their economic and legal situations and portfolios to see if there is any “missed asset” or “missed legal or accounting step” that could solve many or most problems and that analysis would include determining if there is a gold-plated, “Get Well Today “Lender Liability claim buried somewhere in those files. No one should approach the lender with such a claim in any other way but based on fact and through experienced legal counsel. This avenue usually requires some preparation before the “The Big Borrower Pushback” such as tuning up entities, asset firewalling, some forensic retro-appraisal work and the generation of legal research for the rules and laws broken by the lender, the bulk of which will end up in three ring binders listing claims and proofs to slam down in front of lender’s surprised counsel in the conference room.

**TOUR CONCLUSION: THE LONG, SLOW ROAD:**

So for the patient, us and the US economy, right now it’s not economic Armageddon and it’s not Nirvana, it’s not Hell and not Heaven. It could be *Purgatory*, but from that one can exit for better and the best non-politicized basic statistics suggest we are incrementally doing so. This slow pace and lingering market ambiguity is not a “first.” U.S. Crashes since WWII usually go down at 45-degree angles, recoveries usually come up as long, incrementally 1-2% upticking flat lines, followed by sudden 65-degree sweeps upwards (which can often lead to bubbles, but the Brightest among us should always get uncomfortable as “sudden, headlong, reasonless, galloping price increases” ensue and will bail just about 10% or less short of the precarious final peak where the Dummies and the Greedy finally drive the market to fatigue and go explosively broke) . As Kenny Rodgers sung , “knowing when to hold…and when to fold” is paramount in gambling and, likewise, in investment and economics whether on a small or a large scale. As we found last time, “ever more, ever upwards, forever” was a hoax (and always was historically and will surely not change in the future as the world mints fools by the millions) and thus we should try not to duplicate the same mistakes that got us here and expect a different result when The Recovery gets moving more rapidly.

Right now, we are in that slowly elevating flat line point, 6 years after the first hour of The Crash, 2 years into the beginning of the slow rise. It’s going to be modestly inclined for a bit longer before the takeoff and a lot of side issues as noted above could stop or derail it. Knowing that this could take some time, in any well-reasoned impression, it makes sense not to wait it out but to get started actively on creating one’s own recovery right now on the economics of TODAY as discussed, above. One wins the economic bet either way by doing that. If the economy does not recover fast enough, earlier intervention allows one to last it out or at least to last longer than what would have been the case without early intervention—one can work now to snatch probable success from likely defeat if things stay as they are. On the other hand, if the economy recovers more quickly than anyone anticipated instead, then there are greater upside profits to be made when it happens if one NOW lowers debt or now magnifies assets when the economy is on its backside and creditors and sellers more amenable to debt write-downs or dump-offs for the old assets. *For the Bold with the Gold, the solution of the millennium is to move NOW to obtain all those A-plus undervalued properties out there begging for the heartbreak giveaway prices of today--properties capable of being bought for so low today that they will make their owners and investors bloody fortunes in tomorrow’s inevitable payday****--and then patiently, quietly…..sit on them and wait for that moment.***

Warren Buffet has said the first mistake in the last market was product **over**-valuation and that The Crash was inevitable and even “right”. But he also believes that the second market mistake, today’s, is product **under**-valuation and that this is a 10- point “buy sign” on the Economic Richter Scale for the Wise. He says his favorite mantra is “…be fearful when the market is greedy, but greedy when the market is fearful…” He believes the second part of that is where the brightest, the wealthy and powerful of tomorrow and those who advise them, should be **arranging right now**. There are many signs in the marketplace right now that he is **absolutely right.**

***‘Nuff said.***