



Berkshire

DIVIDEND STRATEGY

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“Casual Friday” Commentary

Casual Friday: CRE Unpacked + Putting The "M" Back In SMAs? – March 1st, 2024

#TGI-Casual Friday!

Berkshire Tax Alpha Transition Program

Sometimes it's performance, a need to outsource, or manager rationalization... Do you need to switch strategies but worry capital gains might be an issue? Technology unleashed a proliferation of “tax managed” services to advisors and end clients... Advisor complaints of these offerings? “They are too complicated” “I don't want to track an index”, “the fees are high”, “My clients don't want a zillion confirms” or “why didn't the tracking error model work this year?”

Replace with: Berkshire's simplified, white-glove approach to create tax-friendly transitions to a dividend growth portfolio clients can embrace.

Berkshire will analyze, customize, and monitor EACH account according to the clients: tax budget, time frame, and holdings. We provide a detailed before and after simulation and discuss with you and your client. Experience often tells us that thoughtfully keeping just a few high-quality large-cap holdings vs. blowing out the whole portfolio at once may go a LONG way. It's how we put the "managed" back in SMA. Advisors may gain from the portfolio itself, as well as exceptional practice management support... all done at a “grid-friendly” fee structure.

Detailed program logistics: [Berkshire Tax Alpha Transition Program](#)

Do you have a portfolio that you'd like analyzed? Simply email us a spreadsheet with holdings, cost basis, market value and a brief sense of the tax budget/objective.
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CRE Unpacked?

Advisors / clients fretting over the “next 08” point to commercial real estate write-downs as a potentially “destabilizing event”. Higher rates, work from home, and recession fears all threaten commercial real estate – particularly office-related properties.

Are the fears warranted?

By the numbers:

Today's CRE debt exposure in the banking system? ~\$3.5 trillion – roughly \$1 Trillion is specifically tied to office space -- a far cry from the \$14 Trillion mortgage market of '08. Plus,

the US GDP is roughly double that of '08, lending standards were much higher this round and to boot, “toxic derivative fuel” that torched the entire mortgage and banking industries in '08 isn't visible at the moment or in the news – so far (hopefully 08' lessons were learned). Exposure? Not zero – but seems far more manageable. (Source: Bloomberg)

CRE Valuation: A Lot Like Bonds, Equities:

Like most investable assets, commercial real estate values are formulaic, three variable approach similar to bonds or equities: Risk-free rate, a risk premium, and the cash a property generates. Higher rates mathematically drive lower valuation as does the lower rents from companies choosing not to renew. It's like when a stock: earns less and experiences P/E contraction.

It's important to note the confluence of two factors: Banks offer many CRE loans with a 20-year amortization and a 5, 7, or 10-year maturity but the leases are typically 3 to 5 years. Pre-pandemic loans are maturing at a time when fewer and fewer are signing a new lease.

How are banks responding?

They're slashing building valuations on CRE mortgage renewals, asking developers and owners to bring additional collateral to the table, and attempting to swap paper with one another. Pockets of fallout are likely to make the news. Estimates show Office CRE valuations declining roughly ~30%. We've heard anecdotal stories of ~50% markdowns. Most of the larger banks don't have material exposure and are very likely capable of navigating write-downs and workouts on these loans with nominal liquidity impact. The smaller banks are more exposed and geography matters at the moment. We continue to monitor. (Source: Bloomberg)

The Good News?

There's likely opportunity, in time. Many banks and REITs are trading at sizeable discounts, pay attractive dividends and maintain quality balance sheets, in our opinion. For REITs, those with exceptional balance sheets will likely acquire “cheap” assets in the coming years. Private funds are raising considerable dry powder for distressed properties and making deals, offering support to the market. <https://www.wsj.com/real-estate/cash-flush-buyers-dip-into-distressed-commercial-real-estate-13724a94>.

The New “GOAT? PSU Wrestling

- The Nittany Lions are rolling toward their 11th national title in 13 years
- They've won 55 straight dual meets
- 8 of 10 wrestlers are expected to become All-Americans this season and 5 are expected to be wrestling in the NCAA Finals!

Maybe you are not a fan of wrestling, but something special is going on in “Happy Valley” and it's a showcase of excellence!

<https://www.ydr.com/story/sports/college/2024/02/22/penn-state-wrestling-how-cael-sanderson-built-top-ncaa-dynasty-iowa/72204368007/>

Have a great weekend!
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