The Institute's Real Estate Investment Strategy*

By Maury Seldin**

Principles and Policy in Developing an Investment Strategy

Some Real Estate Investments of a Small Institution

The Homer Hoyt Institute is a small foundation serving as the support organization of an Advanced Studies Institute. Its investment objectives call for sufficient income to continue support within a set of risk constraints intended to preserve capital and provide sufficient liquidity for acquisition of problem properties as part gift and part sale, commonly known as bargain sales. It operates to achieve goals alluded to in the Preface and the first chapter of this book.

This discussion will focus on the real estate investment strategy over the past quarter of a century. It is important to deal with such a time span because conditions change and so portfolios may change as an adjustment to conditions. Also strategy may change.

Acquiring the First Investment. The Homer Hoyt Institute, founded in 1967 as the research and development (R&D) arm of the then Program in Real Estate and Land Planning and Use Program at The American University School of Business Administration in Washington D.C., functioned as a grant receiving institution until late 1979 when it received a gift of a mile of ocean front land from Dr. Hoyt, for whom the Institute had been named since its inception. Until that time there were no assets that could be identified as investment assets. There was no real estate for which to have an investment strategy.

The land was appraised for $9,500,000, including some additional frontage of about 1000 feet owned with some minority interest holders whose interests were valued at 10% of the total value. At that time the objective was to convert the asset (with the Institute's interest valued at $8,550,000) to cash so that it could be in invested to produce income for a grant giving program.

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* This insert is drawn from a book in progress, *Improving Decisions: Toward a New Age of Enlightenment.* It tells the story of the major gift of problem property that transformed the Institute from a grant receiving organization into a grant giving organization. The story is used in the context of developing ideas of interdisciplinary approaches to interdisciplinary problems and of application of principles identified in one discipline to situations dealt with by use of other disciplines.

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Selling the land was a great problem because there was great uncertainty as to its potential use. The land area totaling 387 acres included 60 acres of submerged land. The remaining 327 acres included a 5 acre lake and 196 acres of swampland that contained mangroves. Thus, there was 126 acres of dry land, and much of that was not buildable because of the coastal setback requirements.

If the Institute were offered the property today it might be turned down because the risk of converting to cash within a reasonable period of time would be very high, with a cash drain from property taxes and other expenses that would use a disproportionate amount of the Institute's income. That is to say that the investment might take the portfolio out of balance.

Furthermore, The Institute has a momentum that could be destroyed by the burden of carrying the land. Financing the land, if financable, would increase the risk to the Institute so that leverage would not be appropriate. The timing and the location of the land would work for the investment value of the land, but as just noted, the timing might not work for the Institute now because it has its ongoing responsibilities as the support organization for the Advanced Studies Institute and the Institute might be wary of the liability involved in incurring vast costs to achieve developability, the success of which would not be assured. The back-up of selling the land for preservation might be an option. The decision would require a great deal of analysis.

As to "think network," [the thrust of the Barabasi book] the Institute is a major node, i.e., hub, in academia and industry with opportunity for more suitable gifts of real estate without jeopardizing the academic operations. Board policy, developed out of recent consideration of limits of exposure, would be more likely to accept a smaller project and perhaps one will come through the Hoyt Fellows or other sources.

However, in 1979 the Institute, although possessing a credible record as a grant receiving organization, was prepared to have to close its doors if it were not able to safely convert the land to enable it to become a grant giving organization. It had changed its official relationship with The American University and while it continued to perform the function for the Real Estate Program, the academic environment had changed and the Institute was willing to take the risk. It had less to risk then and more to gain. There is an analogy here relative to the large majority of terrorists who have in their eyes little to lose from their current quality of life, except for life itself, and much to gain in their view in a hereafter life of a martyr.

<u>Disposing of the First Investment.</u> Most interested buyers for the land were interested in a deal contingent on developability so that if the purchaser were not able to obtain the permits they could cancel the sale. Others were interested in joint ventures with the Institute putting up the land and the developer financing the development with the land as security. Neither of these was attractive to the Institute because the purchaser/developer could, upon finding the property not sufficiently developable, opt

out leaving the Institute with tainted land, i.e., land already demonstrated as not developable.

The solution to the design of a sale that could balance the risks between seller and buyer was to scale risk and reward with a variability dependent upon the permissible number of units for development. Dr. Hoyt had when he got the land back after the first sale many years earlier started with an asking price of $3,000,000, but as growth in tropical Florida moved towards the property he raised the asking price to $6,000,000, and then again over time to $9,000,000. When the Institute offered it for sale the asking price was $12,000,000. Growth was moving up the coast with spurts in momentum and with the subject location getting better. Nodes of development were being added to the network of ocean front communities so that the land was getting to be more attractive for development.

The sale designed was with a contract price of $10,000,000 with Campeau of Florida, a subsidiary of a Campeau of Canada. The price was, however adjustable. If more than the stipulated number of units were permitted the price could rise to as much as $12,000,000. If less than the stipulated number of units, the price could fall to as little as $8,000,000. But, the down payment was $1,000,000 and semi-annual interest payments were $375,000. The developer was obligated to proceed with efforts for development at the developer's expense and to turn over permits and associated documents relating to the efforts if the project were abandoned. What the developer needed was an ability to withdraw if the project was not feasible and at least get back the money paid to the Institute.

The solution was to promise to return the down payment and the semi-annual payments if the developer chose to withdraw. The difficulty with the promise was that the Institute immediately began a substantial grant giving program upon closing of the sale and was using the down payment and then the interest payments for the grants. The grant program was quickly rising towards the planned level of $500,000 per year with Florida State University to receive $100,000 per year, University of Florida $50,000 per year, and an array of other universities the balance. We believe that the developer was able to make better progress with the permitting process under this arrangement than if the seller had been a private person and kept the proceeds for his or her own personal purposes.

The environmentally sensitive land had a tremendous permitting problem. See accompanying box for some key items. The network of agencies was awesome. Yet, a momentum was built that was respectful of the environment and a level of permits acceptable to the developer was obtained and the price fixed at $8,000,000.

Among the permits obtained were the following:

From the Corps of Engineers: a permit to perform work affecting navigable waters and discharge dredged or fill material into the waters of the United States and a permit to fill 28.31 acres of wetlands for condo construction, parking and access roads, tennis courts, commercial restaurant facilities and install 14 culverts through impoundment dikes and construct a boardwalk/observation tower in impoundment 2;

From the Department of Environmental Regulation (DER): a permit to prepare land for residential and commercial development that included placing approximately 249,182 cubic yards of fill in approximately 28.31 acres of mangrove wetlands;
From the Department of Natural Resources: a permit to conduct activities seaward of the coastal construction line including selective removal of Australian Pine trees, placing sand fill on dunes, landscaping and stabilizing land fill with salt-resistant vegetation; and
From St. Lucie County: an approval of the site plan.

The plan, in the event permits were not obtained, was to pledge land in proportion to the cash paid to the Institute with a stipulated front foot valuation and to use a two to one ratio. Thus, if the Institute took the land back with the obligation to repay, the security would be a portion of the land sufficient to give the developer an asset to donate to the State of Florida or to a tax exempt environmental group and take a tax deduction. Fortunately, the developer got permits and did not have the right to terminate the process with a return of funds.

Unfortunately for the developer the market deteriorated during the time it took to get the permits and the developer decided that it was in their interests to transfer the property back to the Institute with a deed-in-lieu-of- foreclosure.

The grant program was rolling along and the Institute now had land that was developable and it needed a new strategy. Balance again came into play, but this time the Institute could take the role of the developer, which it did by hiring two of the key executives who had worked with Campeau of Florida, the company that returned the land.

The momentum for development was rolling along. So the opportunity to develop was worth exploring. As believers in understanding the system, the Institute studies the composition of the market to find the niche that was under served. New methodology was developed to identify the best segments to serve. Based upon identifying that segment, the Institute, through its subsidiary, which I wanted to call Shifting Sands, but settled on Treasure Beach Corporation, started the development process. (Finding the niche required advancing the state of the art. The methodology and example is reported in the literature [*Real Estate Market Analysis: Methods and Applications,* edited by John M. Clapp and Stephen D. Messner, Chapter 9, “Absorption Analysis” by Maury Seldin and R. Thomas Powers].)

That process of moving ahead involved preliminary design of the first building, a 60 unit condominium, and the land development necessary to support the building, its service areas, and access.

The key to the land development is the fill permits and the fill itself. The permits called for approximately 249,182 cubic yards. Obviously not all of this was needed for the first phase, but a start was needed. When I told the new staff to start the fill process, the question asked of me was how many trucks. So I asked how much fill can a truck handle. The answer was 18 to 20 cubic yards and eight or nine trips per day depending on whether they are hired by the day or the trip. I replied, “One truck, but I want it every day.”

At the same time this former vice president of the Canadian subsidiary was working on the development he was working on a sale of the land to the State of Florida under its preservation program. The one truck a day, with its eight or nine trips was enough to spark 3,000 letters from the Turtle Mothers to Tallahassee. I don't know how they networked, but the land got on the list for state acquisition in record time.

More on the disposition of the land is discussed later in the chapter. The end result, however, can be revealed now. The land was sold for cash to the State of Florida and the Institute continued its grant giving program.

The proceeds of the sale were invested in laddered treasuries. That was a continuation of the policy pursued while the Institute had the potential obligation to accept a return of the land from the developer/purchaser and repay the funds provided to the Institute. Laddered treasuries refer to staggered maturity dates, so that the Institute faced an interest rate risk for reinvestment, but no liquidity risk in terms of having cash available for operations and minimal liquidity risk in getting cash for investments.

The price level risk was offset to some degree by the high level of prevailing interest rates that served as compensation. There was still some exposure from changing rates of inflation, but the Institute could live with that. Of course, with U.S. Treasuries there is no business risk. This investment strategy served the Institute well for its time, especially since funds were available for acquisitions of real estate that was part gift and part sale, commonly called "bargain purchases."

Investing in Office Buildings. While the Institute was comfortable with the laddered treasuries, an opportunity arose for an investment in a small office building in Prince George's County, Maryland. It is a two story structure without elevators. Access from the street level was up a half flight of stairs or down a half flight of stairs.

Under newly adopted the federal government guidelines, the building's prime tenant, the National Park Service, was required to vacate unless handicap access was provided. Adding elevators was not economically feasible. The result was that the building lost the main tenant. And, tenants satisfactory to the owner were not found.

The owner, having built the structure almost twenty ears earlier, had taken most of the depreciation, but still owed about $100,000 on a mortgage. The property was valued under an MAI appraisal at $400,000. The county assessor assessed it for $400,000. The owner thought it was worth $400,000. Everyone thought it was worth $400,000 except perspective buyers that were contacted.

The owners offered to give the property to a hospital as a gift, but the hospital would have just sold it for quick cash and possibly jeopardized the amount of the tax deduction. Also, it wasn't clear that they would take it with the mortgage on it.

It was then offered to the Homer Hoyt Institute. The Institute gratefully accepted the gift, subject to the mortgage which it paid off at closing. The Institute looked at the building differently than the previous owner. The result was a standard for tenants lower that the previous owner had envisioned, and a rent up of the building that initially produced an annual cash flow well into the twenty thousands per year and then into the thirties. After about a decade it was sold to a tenant for $425,000.

The relevance goes beyond the portfolio issues. Clearly as an income producer to support the grant programs the investment was outstanding. The relevant point is that buildings go through life cycles. That building was in transition from a maturing stage to an aging stage and simply became more suitable to a tenancy expecting a quality of space less desirable than that found in the absorption stage and early maturing process. See the accompanying box for a discussion of the life cycle of a building with particular reference to the relevant stage of life.

An office building requires a capital investment for its creation. The reward is a stream of income that declines over time with the result that the building loses value. The following excerpts from *Real Estate Investment Strategy* by Maury Seldin and Richard A. Swesnik, convey some of the elements of the risk and rewards through which the investment may be viewed.

"En route to the end of the building's life, the rents will drop…Also as the building ages, the expenses will rise. There are four recognizable stages through which the property will progress. Although ordinarily slow, each change taking a decade or longer, the changes do occur with the passage of time. Each of the stages in the life of the property, on the downside of the pyramid, has a different level of risk. The investor may choose the kind of risk he can accept and will seek to be compensated for the risks he takes. [Page 91, 3rd Edition.]

A new balance was required for the role of the building in the array of space suppliers in its local market. The momentum of the loss of the major tenant hurt the chances of retaining and adding tenants. The key was understanding the system and being willing to accept reality

Years after the first office building acquisition, another opportunity arose for an office building investment. The Institute was in the market for expanded office space in the North Palm Beach area. There was a well located very troubled building. The building was half empty and half of the tenants that occupied the leased space were in arrears in their rent. Thus, the rental income was about a quarter of what the building would produce if well tenanted. The property was available for lease or purchase. The owner wanted 1 ¾ million dollars as a purchase price.

A check of the records showed that there had been a recent recorded sale of the property at a valuation of $2,000,000. But that was as part of a trade (two one-million dollar cats for one two-million dollar dog). The tax basis of the new owner was transferred to the subject building from a previous investment and he wanted to get out of this property into something more suitable for his purposes, including further deferring the tax liability associated with his low cost basis reflecting substantial depreciation previously taken.

A long story short, the Institute acquired the building part gift and part sale at the valuation of the 1 ¾ million dollars, but in this case had to actually pay more than half of the purchase price in cash with the gift portion being valued at less than one-half of the property's value. The Institute immediately spent $100,000 to renovate the building and rented up the space at what may have been below market rents. It worked for the Institute because it provided home office space and enough of a cash flow to justify the investment.

A look at the principles involved showed some similarity. The aging process and weak market had snowballed and the owners were not grasping the reality of what needed to be done. The reality was a renovation with a new look and strong management. The cash flows became attractive and the building has now been held for over ten years. The book value keeps declining which doesn't make the financial statement attractive, so a sale is considered.

The Institute has negotiated with some potential purchasers at around the $2,000,000 mark but hasn't closed on a sale because the Institute would remain as a tenant subject to new management, and finding the appropriate buyer at the acceptable price has not, as yet worked out. At this writing the rental market is weak, but the space is fully occupied. The location is getting better because of the surrounding development, and time is on the side of the Institute. The Institute will probable wait for a better balance in the market and sell when the buyers see an upward momentum in the rental rates. The biggest advantage to selling is that it would free up cash for another bargain purchase of similar or larger size. Cash is available for an acquisition of a smaller property. The key is to keep a balance in the portfolio….

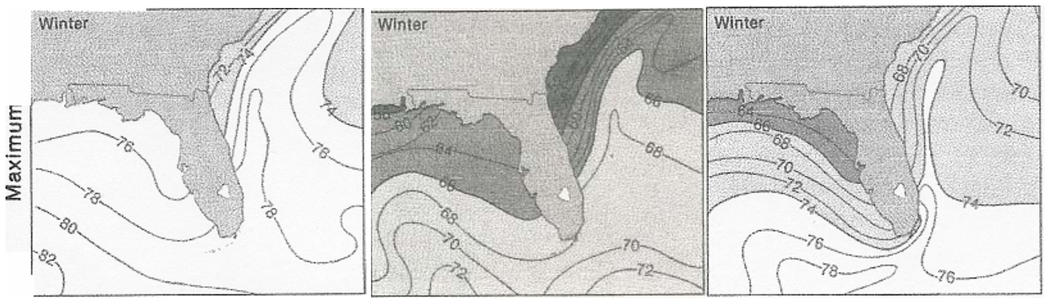
…..Understanding the System. This concluding section of this book, "Part III Strategic Decision Making," comprised of three chapters, focuses on some fundamental laws or basic principles that apply to a variety of disciplines. These are used to show how disciplines may draw from a unity of knowledge and reach better decisions using the strategy for dealing with terrorism as an example.

The brief discussion of the land that became known as the Green Turtle Beach project may have revealed to the reader that good decision making starts with understanding the system. Dr, Hoyt, when he assembled the parcel did so with the understanding that growth along the east coast of Florida was going to proceed in a northerly direction from the heavily urbanized areas of South Florida. The coastal area is warmed by the Gulf Stream that turns away from the east coast of Florida at just above St. Lucie County in which the land is situated. See box . [Contains map from page 35 of *Atlas of Florida*].

NATURAL ENVIRONMENT

The Gulf Stream is a current of warm water that flows out of the Gulf of Mexico, eastward past the southern tip of Florida, and northward along the Atlantic coast. The temperature pattern indicates the position of the Gulf Stream in most of these maps of sea-surface temperature. Its day-to-day changes and its meandering path, however, cannot be seen on these maps. The color pattern indicating sea surface temperature shown on the map of maximum winter temperature results from the effect of the Gulf Stream on surrounding water and does not define the width of the Gulf Stream itself, which is relatively narrow…

Sea Surface Temperature in Degrees Fahrenheight



Maximum Mean Minimum

Excerpted from *Atlas of Florida* ,edited by Edward A. Fernald and Elizabeth D. Purdum, page 35.

Among Dr. Hoyt's theoretical contributions was his sector theory of city growth and structure. He simply applied the theory to the coastal area and it was obvious to him that the time would come when the market for land would be so strong that it could support a high density development. His early promotion of the land showed that vision.

In fact, he has sold the land to a developer who started development but went bankrupt. The timing was a little early and the developer got caught in the down stroke of the cycle. When the Institute sold the land to Campeau of Florida the buyer had a vision of a luxury development. But, the timing did not work for them. By the time they had permits to develop the land the market had deteriorated and the land was less valuable than envisioned under the earlier circumstances. The location is great, but as discussed earlier, timing is critical. [See the end of Chapter 6, Discipline Perspectives: Organizing Knowledge," side heading of "some Underlying Principles," subheading of "Timing and Location."]

When the Homer Hoyt Institute initially acquired the land, the issues of timing, location, and markets was the relatively easy part. The really difficult part was the developability of the site. When the Institute got the land back from Campeau of Florida it understood, through research, that the realities of the market were such that even in the then overbuilt market, there was a segment of the market that could be served by development. With that understanding, the Institute started the process for a first building of 60 units through its wholly owned subsidiary, then known as Treasure Beach Corporation, now operating as Hoyt Advisory Services. The key in the feasibility of these projects is market absorption. [The absorption analysis used by the Hoyt Advisory Services (nee Treasure Beach Corp.) is published in book edited by John M. Clapp and Stephen D. Messner, *Real Estate Market Analysis: Methods and Applications*, as the chapter titled "Absorption Analysis," by Maury Seldin and R Thomas Powers.] Development would have proceeded had the State of Florida not bought the land. But, the Hoyt Institute understood the environmental sensitivity of the land and the State of Florida's interest in preservation.

Understanding how to deal with the environmental sensitivity, accompanied by massive regulation was the most difficult part of the development process. The Canadian developers were far better suited to dealing with the regulatory authorities than those who had the schemas in their minds home grown in the United States. The Canadians understood the system better because Canada is even tougher in its regulations than is typical in the United Sates.

Because of the developability risk, as discussed earlier in this chapter under the subheading "Acquiring the First Investment," it was essential to understand the income tax system in order to be able to strike a deal that had acceptable risks to both buyer and seller. Indeed, the developability risk accounted for the great difficulty Dr. Hoyt had in finding a buyer on acceptable terms after the first developer's fiasco. He was looking for standard terms on down payment with normal contingencies. That would not fly and he was getting on in years with the danger of dying with the land in his estate. The government would want the estate taxes in cash and the only liquidity in the land was the ocean, the inter-coastal, an interior lake, and the swamp. Dr. Hoyt had just sold a major tract of land in Fairfax County, Virginia, and the timing was right for a tax deduction for an "in-kind" contribution to the Institute that had been named for him twelve years earlier and had established a fine reputation in real estate related research on a series of soft money projects, i.e., grants received from outside sources with uncertainty as to future grants.

One of the minority interest holders, when offered the deal designed for the sale to Campeau of Florida responded that it was so convoluted and not really a sale that he would sooner give the land away than consent to the sale. He did to the Institute, and took a $225,000 tax deduction (with no capital gains tax to pay on the substantial appreciated value of his interest). It turns out that per chance he was audited by IRS. But, there was no problem. The value was reasonable. His counterparts with the other 5% minority interest went along with the sale. When the time came to try to rework something with Campeau of Florida, it made sense to buy them out for cash. That is what the Institute did for $250,000 cash.

The fall back position for Campeau if the land were not developable, you may recall was to return the land to the Institute in exchange for a promissory note with land as sole security for refund of the down payment and interest payments made up to the time of return. The land to be used as sole security for the note to be created would be valued at $1,500 per front foot and the loan-to-value ratio would be 50%. So, in the event of the return of the land for non-developability of the land in accordance with the terms of the contract, the down payment and interest payments could be recovered to the extent that there were tax savings from the subsequent contribution of land. The quantity of land to be returned to Campeau would be calculated at $750 per front foot (50% of the stipulated value of $1500 per front foot for the purpose of securing the note) and the tax deduction if Campeau chose to donate the land to an environmental conservation non-profit organization, or the state, would then based upon whatever the fair market value of the land would be, presumably around the $1500 per front foot, and the tax benefit would be dependent on the marginal tax bracket of the donor.

The relevant tax laws are designed to permit these benefits from gifts of appreciated property. It is just part of wise tax planning to know how to use the tools. That means understanding the system. And as noted in the Preface, the Homer Hoyt Institute's counsel, Thomas L. Howard, Esq., understands the taxation system.

The lesson is that the design of a strategy for dealing with terrorism will fare better if those designing the strategy understand the system better. Some points to consider in the design of strategy are now up for discussion.

First, since the terrorists were Islamic fundamentalists, it makes sense to try to understand that culture and their way of thinking. It would be an absolute disaster to assume that they would behave the same way as an American terrorist who was a fanatic on a domestic cause. Their minds do not work the same way.

In Chapter 5 the discussion dealt with the way the mind works. In summary, individuals develop a schema by which they select information for processing and then process the information in the ways in to which they have been accustomed. The Muslims have become accustomed to accepting the word of the Koran literally, but there are various interpretations. The fundamentalists have an interpretation that has a lack of tolerance for other beliefs, but other Muslims can live comfortably under a philosophy of pluralism or at least tolerance.

A strategy based upon Western non-Islamic people changing the views of the fundamentalists is doomed to strategy. We can not directly change their beliefs. The best chance for their belief change, if there is such a best chance, is through fellow Muslims. And if not belief change, then behavior change

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An Interdisciplinary Approach. The effectiveness of a strategy in achieving its goals is likely to be influenced by its having taken into consideration the various disciplines involved. The obtaining of permits for the Green Turtle Beach Project was successful because it went well beyond the economics of the buyer and seller and the business administration fundamentals of both enterprises. It started with the ecological considerations and dealt with them realistically.

Furthermore, it was politically sensitive. Another interesting vignette comes from the sale of the land to the State of Florida. After the land got on the list for the Save Our Coasts program, I was informed that the Institute's priority listing was such that the state only had enough money to buy one-half of the land at that time, but they would give the Institute first consideration in the ensuing bond issue. The option was to sell one-half or go-for-broke and take the chance waiting for a sale of all of the interest in the next round.

As it happens the parcel ahead of the Institutes was in the county of one of the state's leading politicians. The Institute decided to sell a one-half interest in the property. So the was partners with the state until after the next bond offering, and leased the land to them for a dollar a year (and I don't remember our ever getting the dollar).

In case the reader is interested, the back-up was a division of the land if the remaining undivided one-half interest in the land were not purchased within a specified time period. That necessitated the prudence of determining the way in which the site would be split and getting an agreement as to the separation of interests. That took us back to a land use design perspective with the associated problems. But, a back-up plan was in order if one was going to be partners with the state because can you imagine suing for dissolution of the joint interests for an in-kind distribution where the adversary is the state and the court is a different part of the same state.

Beyond the politics, which existed at the local level as well as the state level, there were the implied legal issues. All of this was in addition to the initial disciplines involved from the start which ranged from various branches of engineering to aesthetics of design, and community relations. These had to be blended in the same fashion as the entrepreneur approaches his legal counsel by asking him or her not to tell him what he can't do, but rather how can he accomplish what is desired within the rules. The objective is to design a way to go forward, or shall we say, make progress.

Applying an interdisciplinary approach to dealing with Islamic issues is no small task because the paradigms are different. As will be discussed in the next chapter, some of the leading social scientist that are Muslims object to attempts "to emulate western social science, particularly political science." As is noted in the quotes in that chapter, "..the first priority... must be the development of integrated academic disciplines of economics, politics, and sociology, and alternative operational models for a future civilization of Islam."

As an additional preview, at least with regard to the segment of the Islamic rooted academic community, the thrust of the thinking is that the Muslim academics, instead of engaging in a "cosmetic tampering with what remains essentially a western system of knowledge," ought to be

> "Developing, defining, articulating and promoting the intellectual basis of the global Islamic movement, particularly in the crucial areas of political thought and the social sciences. A major part of this work must be to break the stranglehold which western ideas and thinking have on the minds of Muslims."

Now, the great challenge is to have the Muslim leadership see the same principles for their quality of life as we see for ours, but within their value system, not ours.

<u>Some of the Principles Revisited</u>

Remembering that it is behavior that is our concern for national self-defense, not belief, we need to look towards policies that will influence behavior. This is discussed in the next chapter. But to the extent that we wish to pursue any influence related to belief it would be better done though their fellow Muslims. That is a matter of leverage.

<u>Leverage.</u> That same principle of leverage may apply to behavior. From what I have read [see for example, Chapter 4, side heading "The Terrorist War on America," subheading

"Toward Understanding Islam" and then "Additional Perspective"] Saudi Arabia is not the friend we pretend she is. Maybe the terrorist attack against Americans in Saudi Arabia will cause her to adjust her position against terrorism, but it will not be easy to find a suitable route for the leverage.

Afghanistan, and now Iraq, may offer opportunities as new administrations develop strength. The critical element in both these cases will be balance, both in the representation of the diversity of populations and in the ability to deal with other nations, i.e., internal and external balance.

Balance. Imbalance causes structures to topple. That was the case in the previous authorities running Afghanistan and Iraq. Imbalance also may run amuck as with a cancer.

One way of looking at that is to consider thinking network. A strategic approach might look at the series of countries that are not free and ask what in the course of human events would be likely to improve their quality of life. We thought of the reverse under the "domino effect" thinking of an earlier era.

Inertia/Momentum. Inertia is the law that bodies at rest tend to remain at rest and that bodies in motion tends to remain in motion. It comes from physics, but the principle is applicable to societal activity. Systems tend to continue doing what they do unless forces are present to make change. Unfortunately, now the momentum is for terrorism.

Motion is the natural state of affairs, or as said in real estate appraisal, change is ever present. That is, the natural state of affairs for living things is to grow and die, and then decompose. There is a never ending process of change.

Change is evolutionary when progress is made by structural changes that adjust to external forces. Societies evolve as do plants and animals. The challenge is to get structural change that does away with the terrorism.

Timing and Location. The discussion under "Leverage" is relevant to location in that the issue is where do we find the vehicle for leverage in pursuing the peaceful solution to the problem. That can be with nation states or with segments of the population that are in such states. The question is the timing for a particular location. That will be addressed in the next chapter.

The timing and location principle can be looked at as part of the think linkages issue. There are terrorist cells world wide. They develop out of a linkage process. It makes sensed to deal with neutralizing them also using a linkage approach. The challenge is to start a cascade of eradication of terrorism. If that is not practical, the challenge is an eradication of terrorists.