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Real estate practitioners should focus on real deals - tenants whose leases are up and users who need space

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The deadline for this column was March 19. Not wanting to craft it in a post-St. Patrick's Day stupor, I am writing a week early. However, spring is nearly here officially, so it is only appropriate to look out and comment on what spring might bring for commercial real estate in New Hampshire.

It has been a long winter, mild weather-wise, but still difficult in terms of jobs and the overall economy. The pundits, for the most part, have reset their tapes - "don't look for significant job growth in 2010". Now, the "U"-shaped recovery will have a flat bottom. While we are in better shape than we were a year ago, the markets are not yet energized. REIT's and investors have lots of cash but little to spend it on. Real estate faces a tough slog to recovery (WSJ 1/4/10).

So what are the bright spots? Well, the worst is behind us! Jobs are critical to real estate. High unemployment equates to high vacancies and like the recession of 2002, this will likely be a jobless recovery meaning it will take many quarters - several years - to get back to the employment levels of 2004 - 2006. But there will be significant shifting among sectors. The financial services sector will lag, after all there is $3 trillion less dollars to manage!

The government sector is under stress. Spring is town meeting time, so school and municipal budgets are front and center. The states are struggling too. On February 18, the Wall Street Journal had an interesting article on Chapter 9 of the Bankruptcy Code - noting a provision for governmental entities to file for protection under the Bankruptcy Code. "The economic ship is forcing debt laden cities, towns and smaller taxing districts throughout the United States to continue to consider using Chapter 9... People believe that municipal debt is safe based on assumptions that are no longer true."

Russ Thibeault of Applied Economic Research (AER) talks about New Hampshire's "new normal". He notes that "total personal income in New Hampshire (the life blood of retail and service businesses) declined by $500 million during the past year -- the first decline since the data was compiled in 1969" ... "It will be a challenge to find jobs for the 50,000+ currently unemployed." The new model means slower growth, imposed not so much by wrong-headed state policies, but by national and international forces beyond our control. "Tight state budgets will be with us for a while, and we can expect higher taxes and fewer services to reduce costs."

This indicates that commercial real estate prices could drop another 10 to 15%. This does not mean all properties are going to drop that much. But across categories such as office, manufacturing, retail, etc. the average decline involves maybe 10% or so. Global growth is up and down. Asia seems to be holding its own with Europe less so. Once again, the US seems to be the engine, although it has a very heavy load and will take quite a while to build up a head of steam. So 2010 will likely be much like 2009. The current real estate adage is "to get to heaven, survive till ' 11!".

Thus, real estate practitioners should be focused on real deals -- tenants whose leases are up and users who need space. At the same time, investors will be cautious, waiting for the gap between bid and ask to close before putting hard money down. A key element is when will the next cycle take form, so investors have a better sense of what the opportunities are and what debt structuring will make sense.

This will take a while to sort out. Rich Karlgaard, a Forbes columnist, describes a "New Decade", Huge Questions". Among them are:

* Will deficits and debt sink the US?
* Will health care costs sink America?
* Will unemployment remain high?
* Is inflation or deflation a greater threat?
* Must we trade dynamism for security?
* Can we, and should we, become energy independent?
* Is China a friend or foe?
* Is political bipartisanship dead?

Such macro and global issues can be overwhelming. But first things first. So we individually need to keep our noses to the grindstone. Again, "to get to heaven, survive till '11!" (the big stuff can wait).

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