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The 4th quarter 2010 outlook from the Appraisal Institute

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On October 6th nearly 100 members of the Massachusetts Chapter of the Appraisal Institute and the Commercial Brokers Association attended our annual Economic, Capital Markets, and Investment Outlook at the offices of Wilmer Cutler Pickering Hale & Dorr in downtown Boston. The program was moderated by Bill McCall, president and principal at McCall & Almy. An extensive market overview was presented by four of the region's leading professionals. I have summarized my impression of speakers' comments made that day.

Cathy Minehan, managing director of Arlington Advisory Partners and a former president of the Federal Reserve Bank of Boston indicated that economic growth began at the end of 2009 with inventory restocking, cash for clunkers, and the stimulus. While an inefficient program, the stimulus raised the GDP 3.4% by itself. Nationally, corporations have cash on hand, in contrast to households. Consumer saving has risen from its 0% to 2% historical range to 6%. As consumer spending comprises 67% of GDP, slowed spending will retard growth in GDP. Her recommendations were to eliminate tax rate uncertainty, support fiscal and monetary policies supportive of economic growth, and come to grips with the national debt. Her forecasts called for no double dip, no deflation, an inflation point 2 years away, high unemployment and under-employment for 2 more years, and a long slow economic rebound with a 1.5% to 2% growth in GDP for an extended period. While health care reimbursements will decline, high tech will improve and Massachusetts will fare better than the U.S. as a whole.

Janet Krolman, a director in the Boston office of Holliday Fenoglio Fowler, L.P. spoke regarding commercial real estate finance. Krolman cited the vast disparity in foreclosure rates on CMBS and Life company backed deals. Even so, after massive declines in debt placement in 2008 and 2009, CMBS is back (way up) in 2010. Boston is still regarded as a good market. Not surprisingly, lenders favor prime properties at stabilized occupancy to credit tenants that will exhibit low near-term turnover. Yet, there is also money for distressed core real estate as lenders and investors look at prices versus replacement cost. The volume of deals has improved in 2010 and the largest rate compression has occurred in the multi-family sector. While construction debt is difficult to obtain, bank response is improving. Overall, unlike in 2008 to 2009, money is available for large deals.

Christopher Phaneuf of real estate investment banking firm Eastdil Secured discussed the equity markets. His observations were that dollars are chasing the best and the worst "trophy or trauma" properties. Eleven percent (\$90 billion) of outstanding CMBS loans are in special servicing. While it has been a slow process till now, they are starting to move on this. Phaneuf provided some capitalization rate data on the city's major deals while also noting that DCF's are "out the window" as investors look to a return on cost/equity to bring the property to stabilization.

Jay Spivey, national director of analytics with CoStar Group, is recently relocated to Boston, yet came well-armed with useful data. He began with the "good" news that new construction in the

region is at all time lows and this lack of new supply is favorable to long term property values. Current listings of downtown office are at less than 1/3 the norm and half of that is at Atlantic Wharf. Unlike in 2001, companies are not giving up shadow space and they have not created large blocks of vacant space. As a result, 240 s/f of office space per employee is now 370 s/f. Therefore, employment growth will require less additional space. Inflation adjusted office rents are cheaper now than in 2000 as rents have declined 11% versus 33% in the prior 2001 recession. Mall values have declined due to lower discretionary spending and industrial has been hurt worse than in the prior recession. On the upside, apartments exhibit vacancy rates among the lowest in the country and household formation is expected to increase as the echo boom generation breaks out.

Stay informed. The Massachusetts Chapter of the Appraisal Institute has a schedule of seminars and courses available on its web site. Check for upcoming offerings at www.ma-appraisal institute.org.

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