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2012: What do "we" predict will happen in the job and capital markets and marketability risk

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My end of real estate, the Valuation & Advisory business, more often than not, is a team effort. Teams are created to answer the issues we are asked to address. We interview and work with "market participants".

For the 2012 Outlook, I followed this mantra and interviewed such "participants" as George Fantini of Fantini & Gorga, Peter Goedecke of Goedecke & Company, and Bill McCall of McCall & Almy.

One of the central themes of our discussions was basic real estate economics. Jobs, job growth, or job recovery is what drives the commercial real estate business. In this article, I will start with the issue of jobs and real estate economics, discuss commercial real estate capital markets, shift to what I would call real estate "marketability risks", and conclude as to the outlook for 2012.

The Job Market

CBRE's Global Research and Consulting Group for years has prepared job projections. For the nation as a whole, we have a long way to go.

It will not be until mid-2014 before all jobs lost will be gained back ("barely").

In New England, we are better off than the balance of the country. We have a better business and real estate climate. That does not mean that we will rapidly recover to the 2007 era. The reason is growth in GDP.

Review of PNC's September 2011 Economic Outlook shows a year-end GDP growth of 1.7% and bumping up to over 2% in 2012 and 2013. The problem is that we are far from being back to a 4%Â± growth level which fueled our economy in the 2007 timeframe.

The lag in recovery, as one market participant suggested, is reflective of "gross financial incompetence" and another referred to the Federal Reserve financing the $15 trillion deficit as being "off the backs of tax payers". For Boston, basic economics are far healthier. Unemployment rates are 2% below national averages and our capital markets are stronger than the nations as a whole.

Capital Markets

In Boston, we have one of the Top 5 markets in the United States as caused in part by its basic Educational/Technology/Medical/Life Science structure. There is a healthy supply of money-seeking core assets in which to invest.

The strongest part is the community banks that are strongly capitalized and compete head-to-head with life companies. These banks are capturing 50%Â± of the financing business and servicing typically small- to mid-size real estate transactions which must thrive for a region to remain vibrant.

Capital availability is supporting space markets. The typical average office or industrial lease term is 7 years with a 15% market turnover per year. Capital to support tenants, tenant expansion or retrofits are readily available and is moving our markets in the right direction. Interviewees suggested, however, "special issues" that must be addressed.

Marketability Risk

The simplest definition of marketability risk that I know of is the difficulty of converting real estate into cash to recapture one's investment in a reasonable period of time.

With the drawback since the 2007 peak, landlords have found that there are renewal of leases at rents below what tenants had been paying resulting in decline in net income due to higher operating bases.

With the drawbacks since 2007, markets have "shrunk" towards Boston. Between Needham and Burlington, there is an active market and also in Boston and Cambridge. Rte. 495 is an issue unto itself. The average office availability for Rte. 495 Northeast, Rte. 2 West, Mass Pike West, and 495 South as of Q3 2011 was an incredible 29.85%.

Availability at this level hangs a cloud over the outer suburban belt where there are a total of 254 office buildings, nicely developed but with many locked into the death throws of special servicers, foreclosure auctions, and quarters to half dollars in terms of cash recoveries at best.

Conclusion

2012 will continue to be a recovery year. Even in Boston, while we are ahead of national markets, it will be a long time before across-the-board recovery can take place.

Back Bay and East Cambridge are doing well in terms of office space and the apartment market is separate unto itself.

For 2012, there is expected to be, as one participant described, "a moderate pick-up in action". At the same time, there is huge capital still sitting on the sidelines and will likely remain there for "the longest period in time ever seen". What we truly need for the market to fully recover is for "visionary CEO's" to return to the market. It is the "CFO's" who have cut back on space but the true CEO's are the ones that will drive our market by expanding their operations to the point where major new construction can again begin. Just look at Vertex!

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