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Question of the Month: The economy is tepid - Where is the health of the commercial real estate sector headed?

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For several years now, when commenting upon the status or health of the commercial real estate sector, I have used the metaphor of a light object bouncing along the bottom of a stream, slowly being carried by the current. Some weeks and months things seem to be picking up and then not so much. We have been in this pattern for several years, at least since 2010. My sense is that we will continue this pattern for another 2 - 3 years.

Today, I met with two architects and two general contractors. All four were anxious as their pending work was very uncertain. It can be unsettling to hear such weak projections from other professionals in the development and redevelopment sector, as business often follows behind theirs. We currently have a good book of business in our pipeline, albeit not as strong as a year ago. Many of our clients are uncertain. We have advanced projects only to have clients suddenly decide to back-burner the initiative. So far this year, we sense that the back-burner is in normal ranges, but it may be we are in for a downturn.

At last month's CRE meeting in New York City, several pundits talked about a small or slight recession for 2 - 3 quarters, followed by 6 - 8 years of steady growth. For a guy who is 62, that sounded pretty good! But it is difficult to grasp how anyone can make such bold (and relatively long-term) projections when the global economy is so complex.

While working for a client in New York City, I stay with good friends in Brooklyn. They are excited because the value of brownstones in Park Slope has come raging back. They feel that they are at, or above, their 2007 pricing. We spent one evening discussing which investments (brownstone faÃ§ade restoration, window replacement, new HVAC, etc.) will yield the biggest payoff with a 5 - 10 year hold. When a property suddenly jumps from $1.2 million to $1.6 million or $1.8 million (and rising) then spending $100,000 to restore the faÃ§ade seems like a reasonable idea. Their challenge is that so many tradesmen could not survive the Great Recession (5 years since 2008) that they now must go to contractors they do not know. In the city, that can be a tricky proposition. Having done construction project management in the boroughs and across the Hudson River in New Jersey, the hardest task is finding good, reliable and affordable contractors. There are plenty of contractors around, but finding good ones is still a tough task.

So, returning to the initial theme, anxiety levels seem elevated. No one can truly predict the future, but the conservative view of more of the same or slightly increasing GDP seems safe. The rub is this quiet pattern could go on for a long time.

Our challenge is for the clients who call regularly and want to buy a good investment property. Well, a commercial property throwing off 8%, 10% or 12% is not something you are going to jump to sell in 2013, largely because you will not find a replacement investment with the same level of cash flow. Yet, there are plenty of properties for sale, most with high vacancy or short-term tenants. These are called "value add" properties because they need some magic to get them stabilized and functioning with steady, reliable rental streams. If it was easy, anyone would do it. We scour daily to find the property(ies) that has upside without taking on too much risk. The overall economy is tepid, and individuals' sensitivity to risk is heightened, that is where we are today and where we are likely to be for a few more years.

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