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## Debt ceiling: A concern but worry about underlying issues

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Okay, you're worried but tired of this whole discussion on the debt ceiling. Hopefully, by the time you read this, this crisis will have passed, and we will not have defaulted. If it's already passed, you can skip the rest, unless you want more information as to why you might worry less.

First, let's explore why default on our \$17 trillion of debt will not occur. The main reason that there will not be a default is that what would trigger it would be non-payment of the interest on our debt, which is estimated at \$35 billion per month or approximately \$420 billion annually. IRS revenues for the year will probably be about \$2.3 trillion, so our income is about five times higher than our debt service coverage. So we can, and we will, pay our debt interest, and any shortfall will be distributed among other government programs including discretionary (those which we typically negotiate over the budget) and entitlements (which we typically already owe, i.e. Social Security, Medicare and Medicaid). That will be difficult also, but not an international crisis.

Point #2 is that China and Japan are the largest creditors at a total of \$3.4 trillion, with other countries at about \$2.6 trillion. The Federal Reserve itself owns about \$2.1 trillion, which purchases are intended to keep bond demand high and interest rates low. The rest of the debt is divided among corporations, brokerage houses, banking, state and local governments, pensions, etc. In short, if we want good relationships with China and Japan, we cannot miss a payment. The rest can be managed.

Finally, if we were to miss a payment, our debt would be downgraded from AAA to something lower, and all of our creditors would either stop buying or demand higher interest rates of return in order to accommodate the new additional risk. If we cannot afford an interest payment now, we surely cannot afford a higher one later. Further, if the China's and Japan's of the world stop buying, the quantitative easing under which our Federal Reserve buys our own debt will never be enough to compensate our spending. In short, most everybody agrees, and the stock market concurs showing only modest losses during the threat of this occurrence, that there will not be a default.

All of that said, the crisis raises the same issues, and then some, that we continue to face on an ever more frequent basis than before. We still have the \$17 trillion in debt, and we are having problems with the limiting of annual deficits on each annual budget. It is clear to most that there are only a few ways out, or a combination thereof. Lower the budget expenses, increase the revenues through more taxes, or improve the economy to increase the revenue on the same tax rate basis. All signs are positive that the economy is growing, tax revenues increased during 2012, and subsequently budget deficits decreased. These are all good signs for company expansion and increased demand for real estate, both for investment and because of space needs. However, although every aspect of the economy is in improvement mode, and assuming that the debt ceiling crisis will disappear, at least for the moment, we must be wary that the problem has not yet been solved. It will take a very strong economy indeed to sustain more threats like the ones we have had

over the last year. As I have said before, if more than a few events occur, a "black swan" sequence of events could lead to a more significant meltdown, higher interest rates, loss of certainty, security and ultimately trust. This would be very bad for real estate, with higher interest rates, higher cap rates, resulting in lower values, and more uncertainty in all investments. Stay tuned.

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