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Is it seasonal doldrums or is it a real downturn?

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Over the past few years I have attended numerous functions held by the Appraisal Institute, the Counselors of Real Estate, the New England Chapter of SIOR and NAIOP. The recurrent theme from these programs was that while the residential housing market was "in the tank" the commercial markets were enjoying seemingly endless prosperity. Strong investor demand, endless flows of capital, and tenants demanding large chunks of downtown office space was the norm. Very recently, however, phrases such as "slowed to a crawl," "no ones in the market" and "how long will this last" have been heard at these meetings. Is it a matter of seasonal doldrums or is a real downturn shaping up in the commercial sector?

When analyzing market conditions and where they are going I always look at broader economic conditions and their affect on real estate. However, in my 21 years in the industry I have never seen the convergence of economic conditions that are forming right now. We have record oil and energy costs, a bear stock market, a housing market entering its third year of a downturn, worrisome inflation in the food sector, and a looming recession. And unlike past periods of economic sluggishness that would be cured by the Fed lowering interest rates for a couple of months, there appears to be nothing that can be done this time. The economic stimulus package that sent people checks of up to \$600 last month has done nothing by most accounts. And the expected decrease in mortgage rates that one would expect during weak economic conditions cannot, and will not come because of the weak dollar and inflationary pressures. Happy thoughts!

Indeed one has to go back to the mid 1970's with its "fat" ties, bad suits and bad hair to find an economic environment that felt this way. The feeling of helplessness was so bad then that President Gerald Ford gave up on conventional ways to help the economy and came out with his "W.I.N" (Whip Inflation Now) buttons to try and change the country's economic psyche. Didn't help. So the question remains: What effect will current economic conditions have on commercial real estate and are we simply in a period of 'doldrums' or at the start of a prolonged downturn? The good news is that the fundamentals in the commercial real estate markets are good. Oversupply is not the problem. We don't have rusting skeletons of partially completed buildings dotting the landscape (remember the Quincy section of the Expressway in the early 1990's). We don't have bank failures or REO issues. We do have investors with money, especially foreign, and there remains demand for investment grade properties.

The issue here is stalemate on several fronts. Buyers can legitimately suggest cap rates should be higher and prices lower because the days of easy and creative financing are gone for now. A couple of years ago spreads of 100 basis points over the 10 Year Treasury were common terms for loans. Now, the treasury rates are higher and spreads are 150 to 250 basis points over the 10 year rate. Shouldn't cap rates rise and prices be lowered? But sellers can point to the amount of capital available and the lack of any other comparable investments to justify that prices should not be

lowered.

On the leasing side of things tenants are taking longer to make decisions and are looking for deals at lower prices because of economic conditions. But landlords are holding out pointing to the lack of new construction in the market and relatively low vacancy rates.

This all leads me to believe we are in the "doldrums" and there is not a downturn or depression on the horizon for commercial real estate. Barring some wrong-headed intervention by government, the commercial markets should adjust to the economic conditions and things will start moving again.

Lets hope!

Chris Bowler, MAI, SRA, is the 2008 president of the Mass. Appraisal Institute, Malden, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540