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The good times continue in the New England markets - by Corey Gustafson

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The good times continue in the New England markets, and nationally, as the economic expansion continues. However, it might be time to throw away the complimentary closer that typically follows "and shows no signs of slowing down"- because that just does not fit anymore, unfortunately. Given the significant news arising from a temporary yield curve inversion (the second of the year), it's a good time to think of the state of the times and potential headwinds that may slow this party down.

Overall the national economy has continued to expand moderately. While concerns around tariffs and Donald Trump's trade wars persist, businesses continue to express optimism over the near term. But erratic U.S. administrative policies and the tariffs on consumer goods will continue to be a weight around the neck of all of us.

The one story that won't leave the news cycle is the on-going trade wars, most particularly with China – the #2 economy in the world. While there has been overreaction from investors due to the trade developments (see the repeated stock give backs on Wall St.), at present its only eroded 0.3% of GDP growth. While there can be arguments back and forth about the impact on various industries and products, the effect on commercial real estate is real and requires consideration in both the primary and secondary markets of the U.S. and New England. The trade war is not going away anytime soon with U.S. and Chinese officials at a stalemate. Reportedly, U.S. negotiators want to work off a draft document put on the table in May of this year, but the Chinese have refused. The stand-off is real. And the reason its so important to commercial real estate is the just how pronounced Chinese investment had become in the U.S. in a relatively short period of time. In 2014, Chinese investors flooded the U.S. market following relaxed rules in their homeland as Beijing sought to increase Chinese influence globally. This action, coupled with Chinese currency devaluations caused a flood of foreign investment in 2014 through 2016, with the Chinese growing at the fastest pace. By 2016, the Chinese investments rose to $46 billion and were the largest foreign investors in the U.S. As a result of the trade wars, there has been a near full stop on Chinese investments in the U.S., reflecting a 90% decline (as of first-half 2018). Going beyond the halting of new investments, Beijing has ordered the sell-off of asset portfolios held in the U.S. and there is anecdotal evidence of these sell-offs occurring nationally.

In addition to waning Chinese investment, commodities such as steel, lumber and other construction materials has caused disruptions at points for construction. While domestic producers have stepped up to the challenge, the volatility and price spikes have resulted, and effected construction starts and schedules. Multifamily exports have reported that a project that would typically take two years to complete are seeing delays of up to five months as a result of material shortages (in addition to noted labor shortages). Foreign investment declines, coupled with increased construction risk, are concerns for real estate pricing in the near term.

Looking beyond the direct impacts of the trade war, slowing is noted in other sectors as well. Changes to the Institute for Supply Management (ISM) non-manufacturing index now show the lowest point of the index over the past six-month period. While a rebound of the index was noted in the last month, it was a rebound from the lowest indication since 2016. Again, reflecting a slowdown. Unemployment numbers are still at record lows, but job growth is slowing. The August figures indicate non-farm payroll increases of just 130,000 jobs – this is reportedly mostly due to the hire of temporary workers for the U.S. Census. Staffing agencies are noting difficulty in matching the skills of employees with the requirements of employers, and companies are accepting less qualified workers and offering higher pay rates.

Closing with the local picture, there are certainly headwinds for the national/global economy that will affect the Boston commercial real estate markets. This does not shadow the fact that our local economic picture is the envy of most all other markets in the U.S. With the youngest urban workforce, unprecedented skilled labor, rapidly expanding life science and technology fields, unsurpassed higher education and medical institutions and the stabilizing effects of government labor, there will be on-going stability locally even in the face of headwinds. Boston continues to see robust leasing in the office and industrial sectors. The office vacancy rates are near historic lows and reflect the overall strength of the market. There are presently no risks of overbuilding or overleverage in the Boston CRE markets. Short of the proverbial Black Swan (or more likely orange swan these days) event, we’ll be able to weather any storm together.

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