nerej
EST. 1963 | CELEBRATING 55 YEARS

The “New Normal”: Those that cannot adapt will be forced to transition - by Bill Norton

May 27, 2022 - Spotlights

Bill Norton

Here we are in late May and the commercial sector is hopping along with only retail and office lagging. The Fed announced a 50 basis point increase yesterday (with more to come). The inflation genie is out of the bottle and it is always a guess as to how to get it back in! In this instance, it has been a long time since we have had to deal with any significant inflation. The general strategy is to squeeze, squeeze, squeeze until prices come back down. However, after such a long period with little/no inflation, prices this time will not drop all the way back. The $24 sheet of ½" plywood, which is now $60-$70 (if you can find it), will end up at $40-$50. Eggs that were $1.39 per dozen and now are over $3 will end up at $2-$2.50. Minimum wages will effectively be $15 per hour with increased withholdings (Social Security, Workers Comp, SUTA, FUTA….).

With the large number of cash buyers (commercial as well as residential), high prices will remain for a bit - even with rising interest rates. With residential mortgages in the 5's and rising, and second homes in the 6's trending to 7% many "would be" home buyers will stand down. But with demand still far greater than supply, it could take a while to see sales really tumble and prices drop significantly. One result is that the $400,000 starter home will drift back to $350,000, the $700,000 condo to $600,000...

With rising house prices came rising taxes and large increases in assessments. Real estate tax revenues hit an all-time high in 2021 (over $327 billion). At the same time, utility and energy costs are way up. I look around my neighborhood and wonder if some of my new younger neighbors have overreached? Only time will tell.

On the commercial side, the ongoing high cost of new construction makes existing inventory look like a bargain. Even simple fit ups and refreshes (carpet and paint) have doubled in cost. When coupled with tenants wanting shorter lease term while they wrestle with the Pandemic, working from home, returning to the office, and perhaps a "hybrid" model, it suggests increased rents, but with soft demand and excess space, the market does not support it. Landlords are happy to get cost increases to cover rising taxes and utilities.

I recently read (somewhere) that 87% of employers surveyed wanted to return to the office full-time while only 10-12% of employees did. I assume that the eventual outcome will be somewhere in the middle. Working remote is no big deal for about 30% of the workforce. Some even increase their productivity working at home. Another 30% can do it either willingly or reluctantly, but with some distractions (kids at home, home schooling, remote learning…) there is some diminishment in efficiency. The remaining 30% are likely not as productive and in time that is where "the new normal" will take a bite. Those who cannot adapt will be forced to transition.

The hybrid concept sounds simple, but in most instances does not result in a significant drop in space or occupancy costs. One firm on our floor requires employees to be in Tuesday, Wednesday, and Thursday. with Monday and Friday optional. Another allows flex, giving the employee the choice but requires at least two days in the office. At the end of the day demand for office space will shrink for a period of time, but my guess is that we Homo sapiens are social beings and eventually will return to the office, perhaps at 75%-80% of the previous norm.

Meanwhile demand for high-bay, warehouse/distribution abounds. Alas the cost to build this space has jumped (here in New England to $150 per s/f - $160 per s/f). On a recent road trip down I-95 to Florida, it struck me that while Amazon and others were putting up millions of square feet of mega-distribution centers, in the Sunbelt retail centers are being built or expanded. It seems like a conflict. But perhaps with the ongoing migration to the Sunbelt both can survive and prosper.

Right now, we are super busy, but we suspect that with the rising interest rates, things will slow down by year's end. By how much remains to be seen. As a 40+ year practitioner, I often say we make money in a rising market and a falling market. We have experienced 20+ years of a rising market (with a few blips). But the next 12-18 months will be interesting.

Bill Norton, CRE, FMA, Hon. AIA NH, is president of Norton Asset Management, Inc., Manchester, NH.