

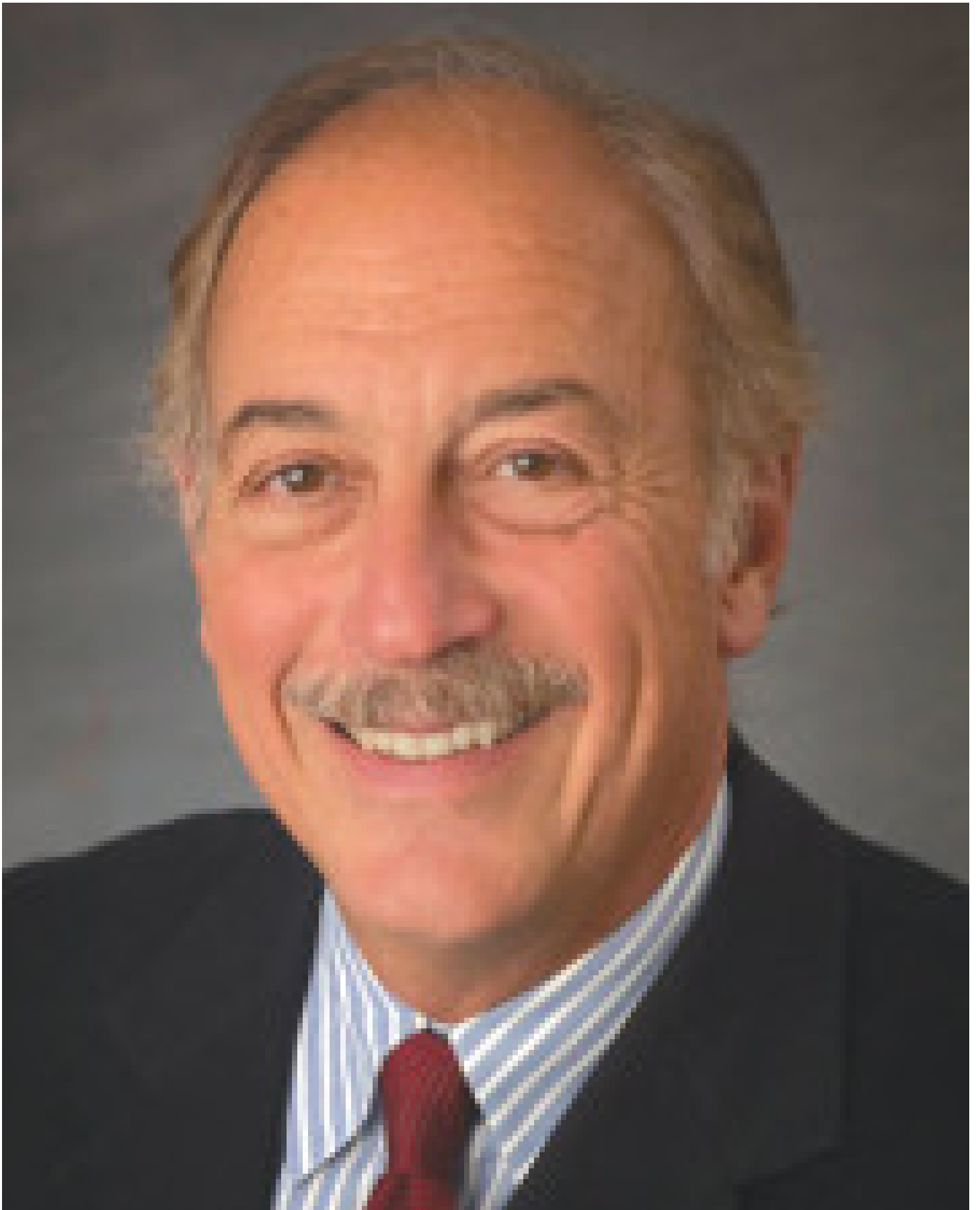


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Economy update... “it’s messy out there.” - by Daniel Calano

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Daniel Calano

Last month I wrote about inflation and its impact on real estate. It was fairly obvious that interest rate increases by the Fed was going to be the main tool to soften inflation. But it was also clear there were other variables which were certainly uncertain and uncontrollable. Examples were the war in Ukraine, unforeseeable COVID impacts, supply chain, China and so on. I thought there might be some clarity for this article. No chance!

A very prominent economist was being interviewed recently and, when asked about the state of the economy, even he could only articulate "it's messy out there". Now, he has a much clearer and broader perspective than most of us, but that was the best summary. What we do know: the Fed is increasing rates, very aggressively, but not certain about how far or fast it will go. The war in Ukraine drags on, suggesting significant longevity. Relations with China continue to be touchy, as is their continued response to COVID. Our economy is strong, particularly based upon job openings and increases, but many assume recession.

Anybody who claims to know the answers to these uncertainties is delusional. Needless to say, the following thoughts should be taken with a grain of salt, only to become more certain much longer into this year. One thing is clear. COVID created a crisis. The Fed tried to mitigate the harm by flooding the markets and people with money: Some by providing cheapest borrowing rates ever; some by buying back government bonds supporting the mortgage market and real estate boom. Now it is trying to unwind those actions in order to cool the economy and with it, inflation. Most economists would agree that financial markets have been manipulated, purposely or unintended, in extreme ways, creating uncharted territories. Thus, no one really knows how the unwinding will impact.

It is useful to consider a few misunderstood factors. For example, there is a typical belief that the population is cash rich, with flush savings due to COVID lock-downs, anxious to get out and spend. This of course would positively impact most retail real estate. However, the factual results have been less shopping, less buying desirables versus needs, and less consumer confidence, which shows some of the lowest polling scores in the last 20 years. Retailers and their commercial domains are feeling the pain.

Housing had one of the best years ever in 2021, clearly due to low interest rates directly lowering mortgage rates. Now with quantitative tightening, rates have increased to somewhere between five and 6%, thus causing the pace of sales to decrease, the affordability of housing to also decrease, and thus less demand. Many simply cannot afford to buy homes, while those who can, may prefer to wait for other economic reasons. As a result, based on the recent 2022 Harvard Joint Center for Housing Report, the country's largest homebuilders are showing weakness in their value, and some reticence for new home construction.

The "work from home" hybrid, now commonly believed to be permanent, has clearly impacted businesses and commercial real estate. The strong economy has produced jobs, but not necessarily willing workers, which, combined with work from home has seriously impacted office and business

space usage. Anecdotally, it is reported that only about 20-30% of urban New York office space is occupied, with other urban areas following suit.

So, it's messy out there. There are many varying opinions on all of these issues...not so many based on fact. As a result, it is very difficult to plan to move ahead on real estate projects of most every type. Clearly, the largest and most affluent participants can look to a more certain future, as they either land bank for that future, or carry the expense of unfulfilled projects for longer time periods. My summary opinion is that this "messiness" is truly impactful and will last quite a while. Others will clearly disagree, but no one can predict, with the level of current uncertainty.

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