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Even with economic headwinds we keep sailing along, hoping the storm will go out to sea or just brush the coast - by Bill Norton

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Here on the third official day of fall, the weather is cooling and to some degree so is the commercial real estate sector. The primary culprit is rising interest rates both for construction loans as well as mortgage loans. While the interest rate is a key driver, terms & conditions are often just as important. Loan to value ratios, debt coverage ratios, conservative appraisals, personal guarantees (full and partial), reserves, collateral...It is a bigger challenge now than even a year ago.

Architects and engineers are reporting that they are still busy but fewer projects are moving from design to construction drawings and specifications (where final budgets can be determined). This is not a deluge (yet) but a clear pattern. Even so, we continue to see cash buyers for residential properties and only a nominal slowing of the very high prices. Nonetheless, those who require financing are feeling the pinch of the higher interest rates. The pundits are less rosey this month than they were on Labor Day.

Overall, in the multifamily sector, there is a sense that rents have or are about to peak and this caution enters decisions about chasing deals at even higher prices. The storm clouds on the horizon (the proverbial “headwinds”) are a warning sign. They have been there for at least three years, but we seem to continue sailing along, hoping the economic storm will go out to sea or perhaps just brush the coast!

I just returned from visiting my daughter and my new granddaughter in D.C. The housing costs there are crazy! (Crazier?). Add in the cost of living and daycare at $500 per week and only government workers can afford to live there. The disparities between the “haves” and the “have nots” grows daily. There is an old adage that “it is a shame to waste a good recession.” The point is that an overheated economy needs to reset and get prices down significantly, that means a recession of at least 1.5 to 2 years, with large layoffs and rapid increase in unemployment, i.e., lots of pain!

BlackRock, one of the biggest investors in all types of real estate has come out cautioning that there may not be a “soft landing.” The head and the deputy head of BlackRock Investment Institute are predicting a continuation of our 18-month flat-lined economy, which makes it the weakest two-year growth stretch in the post-war (i.e. WW II back in 1945!) era aside from the Great Recession/Financial Correction in 2008/09.

They feel job growth is likely to be 0.5% v. 1.5% three years ago, before the pandemic. A smaller workforce will translate to economic growth of 1% v. a goal of 2%. Note: 1% of a 20 trillion-dollar economy is still a lot of money!

So, what does that mean for New Hampshire? Their prediction is for slow growth with steady (albeit tepid) employment. They agree with Fed chairman Jerome Powell that “reducing inflation is likely to require a period of below trend growth”. Now, economics, especially macro economics (sometimes called voodoo economics) is more art than science. There are several possible scenarios. Which one predominates and manifests itself, remains to be seen. For those of us on Main Street all we can do is keep putting one foot in front of the other and hope for the best.

This does not mean that a severe, prolonged recession is inevitable. More likely is a slow rebalancing of several years to get back on track. The dysfunctionality in Washington does not help matters. Each week I am more convinced that it is time to launch a third party. As for the septuagenarian Democrats and Republicans – a pox on both their houses! They cannot (will not) pass a budget. The structural gap in annual spending is now more than a trillion dollars! Interest on the debt is heading toward a trillion dollars annually. The debt is now $100,000 for every man, woman and child. At 4-5% that equates to real money.

I bought a 100 year CD (from Walden Mutual Bank) for my six week old granddaughter. Statistically she should live to be 103. Is that a good investment? By itself probably not (no inflation hedge) but as part of a portfolio of investments it should make sense. I will ask her to submit to New England Real Estate Journal in 50 years a report on that. As a “teenager” in the Baby Boomer generation I am more focused on the next two decades. More importantly I am keen to see how this housing and real estate bubble plays out.

Enjoy this beautiful fall weather, because here in New England, we know what is coming next!

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