



nerej

Groundhog day? - by Bill Pastuszek Jr.

March 01, 2024 - Northern New England



Bill Pastuszek Jr.

The groundhog did not see his/her shadow recently. That means it might be an early spring. This winter has been a strange season everywhere, both in terms of the weather and real estate. Overall, while many indicators pointed positive, nothing feels certain or quite right. Residential markets experienced weird dynamics and commercial real estate performed unevenly and unsatisfyingly with commercial sectors undergoing adaptation, correction, and, in some cases, distress. Let's examine some broad trends applicable to real estate.

The Economy. While the Fed is cautiously signaling some good news about further rate hikes, setting up expectations for rate decreases, it's not entirely clear that rates will be dipping dramatically during this year. If they do, that is good news indeed. Even with lower inflationary expectations, the results of the bout with inflation are a bit baked in to the economy and will continue to be an issue particularly with consumers. Prices are subject to the concept of downward price inelasticity and the concept certainly applies in the current market, i.e., once prices go up, sellers are loath to drop them. And, while retailers are quick to signal lower prices with sales and so forth, everyone has to deal with elevated price levels going forward. A softer job market will limit wage increases.

Someone noted not so long ago, "if things are so good, why do we feel so bad?" Things could be a lot worse but it's a fair question. From the investor side, many investors are simply on the sidelines waiting for good deals. Sellers are still reluctant to adapt to new pricing realities. There are increasing instances of properties selling at large discounts, particularly in office markets.

The stock market is rising to new highs and that buoys sentiment and portfolio. However, the markets have gotten pretty used to volatility and there is some thinking out there that it's too good to be true. For now. CD rates are pretty high: many investors have discovered that cash can actually produce income: it's not a big secret but your local bank won't say much about it. The supply chain for the most part is in good shape, people are working (and continuing getting the chance to do hybrid work), short-term wage growth is outpacing inflation. And there is an adequate supply of new cars and prices have softened to a certain extent.

Residential Markets. The Warren Group tells us, that "Massachusetts single-family home sales fell to a 12-year low in 2023 as limited inventory and record-high prices continued to strain activity." Supply is playing catch up and not very well. Boomers aren't selling, stoking an "aging in place" movement. Sellers aren't selling, feeling cozy with low-interest mortgages. Not a healthy market dynamic. Lower rates should eventually begin to break the logjam. Recent activity suggests possible better times going forward.

Housing Affordability. Housing affordability is a major issue in the Boston market as in many others. Costar notes that "year-over-year asking rent growth has dipped below 3% in Boston, a level that is below the long-term average for the metro... but still above the national figure. Both nationally and locally, rents are expected to continue decelerating into early 2024 before the exhaustion of the supply pipeline helps to tighten the market later in that year. Market rents in Boston are among the

nation's highest at \$2,760, trailing only a handful of metro area. Vacancies have increased but not significantly.

Commercial Markets. Uncertainty has prompted some stubbornness from buyers and sellers. If rates come down, buyers may be more inclined to move. If rates remain high, motivated sellers and lower-quality assets will likely move.

Multi-family and industrial markets remain inviting. Even industrial shows deceleration with higher vacancies and cap rates reported in the Boston Market.

Office markets should continue to be dismal. Rents and vacancies in CBDs will continue their downward trend. The hot trend is in office to multi-family conversions: that trend should continue but represents a partial solution to downtown office markets. Will retail undergo further shakeouts?

The higher interest rate environment has created much activity negotiations, write downs, and distressed property activity. Some movement is occurring in terms of workouts for underperforming, overfinanced properties. COVID real estate effects are weighing on office markets. Tenants not only want less space but insist on paying less rent for it.

Conclusions. Expect to see less uncertainty in investment markets. In Boston markets, there isn't a huge oversupply. Buyers are being picky, as are lenders, and interest rates aren't helping cash flow. Expect to see a lot more focus from lenders on the ability to repay. Will the possibility of an early spring make it a good time to look for bargains out there?

Bill Pastuszek Jr., MAI, ASA, MRA heads Shepherd Associates LLC, Needham, Mass.

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