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## **Northern New England plugs along even with high costs of construction - by Bill Norton**

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Bill Norton

So far it has been a beautiful late summer. Of course, we still have the election ahead! The economy and commercial real estate, seem to be rolling along. Employees are being called back to work in the office, some three days a week, some four and some five. Perhaps up to 70-80% of the pre-COVID level. Office user tenants want less space and lower rents. This is hard to achieve as expenses go up, think utilities, maintenance, insurance premiums and real estate taxes.

We recently re-let two 10,000 s/f office suites. The rent went from \$15 per s/f NNN down to \$10 per s/f NNN but the NNN's are up about \$1.50 per s/f. I believe the working-from-home model will lose popularity with employers because for most workers they simply are not as productive. Yes, they save commuting time, but there is leakage of time from distractions of being at home. To date, that has been "absorbed" during COVID and subsequent years, but with ongoing inflation, albeit at 2-3%, as workers demand pay raises, employers are going to demand productivity. Certainly the technology is available to track and monitor remote employees' activities (calls per hour, claims processed, sales orders completed...as well as zoom calls attended). Water seeks its own level and thus employees leverage over employers will ease, not for all categories, but for many.

And then there is AI. I am reluctant to embrace this. The dark side seems to be a big risk. I recently read a very thoughtful and compelling book – This Is How They Tell Me The World Ends (the cyber weapons arms race) by Nicole Perlroth. This is an eye opener. It reads like an action thriller, alas the dark side potential is very big! Unfortunately, China and Russia are leaders in the dark AI environment (ironically Ukraine is too). This is both by government actions and private actors. The more we rely on digital platforms, the more vulnerable we become. Just recently we learned of Israel blowing up 600 pagers in Serbia, Lebanon and Iran!

Think of the current concern about Taiwan where much/most of the computer chip industry is based. If things blow up there (figuratively or literally) the entire global tech sector suffers. That could lead to a worldwide recession or perhaps a depression. Globalization has us exposed whether we wish to admit it or not.

Back here, northern New England plugs along. The higher interest rates have been absorbed (so far) but the "terms and conditions" for commercial loans are challenging – debt coverage ratios, tighter appraisals, loan to value at 70-75% no longer 80-85%, and in some instances "recourse" aka personal guarantees. Add in the high costs of renovations, fit ups, and code compliance and some deals are hard to pencil. Another key factor is lease term. Tenants generally do not want to commit to longer leases. Landlords want more term to amortize their transaction costs. Some leases do not make sense for the landlord at 3 or 5 years, but do at 7, 8, or 10 years. The latter is a long time for many business tenants. With COVID mostly behind us, the leverage of the employee is slipping – "yes, I want this new job at higher pay, but am I willing to commit to more time in the office to get it?"

The northeast region is still constrained by ongoing high costs of construction (due to shortage of labor both skilled and unskilled, aging labor [with lower productivity] as well as materials availability and costs). Construction costs seem to have leveled off somewhat but are not dropping (yet) and

they will not be going down to pre-COVID levels. These high costs are a burden to single family, multi-family, commercial, industrial and infrastructure projects throughout the region.

This past year has provided me with two granddaughters, one in Arlington, VA and one in Golden, CO. I spend a lot of time thinking about them and what the future may hold for them. One of my recent tasks was to review and update my (five-year-old) revocable trust. For years I have told my son and daughter "I am OK and frankly you two are going to be OK" but beyond that the future is wet, damp, smokey as well as hotter and hazier. The November election will have significant impact on both the near term and long-term future. Be sure to get out and cast your vote.

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