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Owners in need of debt should be in the market today for 2010 requirements

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The three legged stool that supports commercial real estate is comprised of employment, availability of capital and the fundamentals of the underlying markets for apartments, retail business, office demand and the need to warehouse goods. At any given time commercial real estate can perform with one of the legs shorter than the others but what will happen if all three legs are of different lengths? The more important question is whether waiting for all three to rebound is prudent if capital can be found today.

Unfortunately with regard to performance, we may find out in the coming year. Most economists would agree a lag of between 8 and 12 months exists between job creation and resultant demand for commercial real estate. Since the beginning of this recession in 2007, the economy has lost nearly 7 million jobs and while the rate of job loss seems to be abating, there is no indication of job creation in the near term. If the economy were to start growing jobs before year end, the best case scenario would have demand for commercial real estate increasing sometime near the end of 2010.

The continued loss of jobs in the near terms portends continued softening on the demand side in 2010 for retail and office, which probably means less demand for industrial, although this sector looks to be performing better than the other sectors. The crash in housing has meant increased rental demand for multi-family but jobs losses may lead to increased vacancy.

It is no news to anyone in the industry that debt capital for commercial real estate is scarce today. The excesses of the commercial mortgage backed securities (CMBS) market are just beginning to manifest themselves in record delinquencies. There is over $28 billion of CMBS currently in default. Nearly $50 billion is now in special servicing and there is no indication of deceleration in the pace of delinquencies. Commercial real estate desperately needs a securitization market but with performance deteriorating and spreads remaining wide, it is unlikely that CMBS will be a viable source of capital next year.

According to the Mortgage Bankers Association of America and the FDIC, non-bank and non-life company maturities of commercial real estate debt will exceed $90 billion in 2010. Bank maturities will approach $25 billion and life companies maturities will add another $20 billion to the total. The Federal deficit is now projected by the CBO to be $1.5 trillion this year and over $1 trillion per annum for the foreseeable future. China already holds a trillion dollars of our debt at an interest rate of 4% while the Federal Reserve has necessarily ballooned its balance sheet to over $2 trillion and doubled the number of dollars in the monetary base, an unprecedented of increase. Will China continue to buy our debt at a 4% yield while the dollar deflates at 10% per year?

Where will the capital be sourced to satisfy the demand for commercial real estate in 2010? Regional and local banks appear to be filling some of the void and the life insurance industry has replenished its capitalization either by raising cash though stock issuance or long-term borrowing. This means that after banks and life companies meet existing client demand for refinancing, there may be $30 to $40 billion of capital available to fill a maturity void of nearly $100 billion. The best description of the market is "spotty" with pools of debt available in various amounts and at varying maturities from week to week. It requires a Herculean effort to stay in touch with constantly changing capital sources. Relationships are once again paramount and trust is in scarce supply.

Under the circumstances, owners in need of debt should be in the market today for 2010 requirements as time is not likely to be a friend to commercial real estate finance.

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