



Commercial real estate signals moderating growth

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A forward-looking index for the commercial real estate market recorded its ninth consecutive improvement in the second quarter of 2007, according to the National Association of Realtors. Forward-looking evidence on nonresidential investment has been positive, suggesting this important sector of economic activity may continue to offset much of the drag from the correction in the housing market. The Commercial Leading Indicator (CLI) rose 0.5% to an index of 120.7 in the second quarter, the highest on record, and is 1.1% higher than the second quarter of 2006 when it stood at 119.7. The methodology applied in creating this fairly new index mirrors that used in the computation of the Conference Board's Leading Economic Indicator. To accurately capture the ebbs and flows of the commercial real estate market, the CLI uses 13 variables that the National Association of Realtors believes positively correlates with commercial real estate market flows.

While the commercial real estate market is expected to grow, albeit at a slower pace in the third and fourth quarters, the risks are heavily geared to the downside. The era of easy money has come to an end. Until very recently most of the tightening in mortgage lending standards had been concentrated in the subprime mortgage lending arena leaving the commercial real estate market untouched. What began as concentrated weakness in the subprime mortgage market has rapidly evolved into a credit crunch for many sectors of the economy including commercial real estate. The lack of liquidity has started to affect business sentiment, causing firms to pullback on expansion and hiring plans. According to a recent survey by the Federal Reserve Bank of 53 senior loan officers at domestic banks showed 14% were tightening lending standards for prime residential mortgages, and 25% of lenders were beginning to rein in standards on commercial real estate loans. The combination of slower economic growth and tightening up on commercial real estate lending standards may pose a significant headwind to nonresidential investment. Despite these financial headwinds the strong global economy, improvement in factory activity and healthy export growth will put a floor under the demand for commercial real estate for the balance of 2007.

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