



2010: Where are we heading, or will we need to wait until 2011/12 to find out?

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As we approach the first quarter of 2010 with the record lows of 2009 behind us, what can we expect for the economy, real estate capital markets, housing and commercial/multifamily investment property?

As for the economy, the two most important drivers are the unemployment rate, which still hovers at 10% and the federal government's forecast deficit, which will exceed \$4 trillion for 2010 and rising. As for unemployment - what drivers or industries will sustain or transition into job growth in 2010? As for the U.S. Federal Budget Deficits - the real deficit number with Social Security and Medicare will exceed \$10 trillion. In fact, the total Federal Obligation under GAAP was estimated at \$65.5 trillion in 2008 according to ShadowStats.com. This figure exceeds our GDP according to the U.S. Treasury and will result in a rise in personal and corporate income taxes over the near term, along with new fees and levies.

In focusing on the real estate capital markets, private equity funds have amassed substantial equity to take advantage of the distressed marketplace, along with the REIT sector. Also, CMBS issuance has resurfaced and may become another alternative for real estate funding under more prudent structuring and fundamentals in 2011/12. Commercial lending alternatives are available, but at lower loan-to-value ratios and increased debt coverage ratios. Selectivity, borrower track records and liquidity will be the key drivers. Transaction volume is still at all time lows, coupled by increased inventory in all real estate sectors, resulting in excess supply. Capitalization rates continued to increase in all sectors and according to ULI, averaged 8.05% in December. The increase in cap rates is more risk aversion vs. the cost of capital, which still remains low. A common concern is the affect of rising interest rates, coupled by inflation, which appears inevitable by the end of 2010.

As for the housing market, a continued decline in housing starts and housing prices will remain constant until the existing inventory is absorbed and unemployment rates stabilize. We will also need a consistent increase in GDP and consumer confidence to sustain any real up-ticks in the housing sectors. I believe this will not happen until 2011/12 and will be side-tracked by an increase in conventional lending rates and more stringent underwriting. Overshadowing the housing market is rising foreclosure filings, default notices and bank repossessions. As such, no real recovery is foreseeable for the housing sector over the short term, which has now been in a tail spin for over 38 months.

Investment properties continue to experience rising vacancy rates with office and retail sectors in excess of 19% as of the 4th quarter of 2009 according to ULI, coupled by eroding rent levels and concessions. Warehouse vacancies were reported at 13.2%, followed by the apartment sector at 8.6% during the same period according to ULI. Here again, supply side inventories and unemployment ratios need to be reduced before any sustainable recovery will be realized. The

multifamily sector will continue to be the investment of choice, but on a deal-by-deal basis. Locally, the J-51 ruling has created a level of uncertainty, which will reduce buyers' and lenders' interest until a more definitive ruling is made. Local vacancy rates for the multifamily sector should remain under 4%, but increased collections and arrears are common. Also impeding the local multifamily market is the high ratio of condominium developments, which have converted to rentals. In fact, the condo market remains soft with value declines of 10%-20% over the past 12 months.

The retail sector remains flat, with continued consolidations and bankruptcies. Here again, consumer confidence and spending are the major drivers.

Overall, 2010 will continue to "waddle" until the excess inventory of existing and shadow stock is absorbed and consumer confidence is restored, coupled by lower unemployment rates and industry wide deleveraging. These events will not occur until home values stabilize, demand indices are restored and the problematic job growth picture improves. Most surveys indicate that this will not take place until late 2011 or 2012.

Experienced investors are waiting on the sidelines for the right opportunities, with a strong focus on "distressed" real estate. Basic fundamentals will be restored in most by-sell and/or funding options, which should result in higher yield rates and near term returns. However, 2010 will reportedly be the "worst" year to sell real estate according to Emerging Trends - "a test for who can survive". Continued bailouts will be far and few between and banks will need to clear out their non-performing or REO portfolios. As my colleague stated, "fasten your seatbelts!"

Suggested readings include: Emerging Trends in Real Estate 2010, published by ULI and PWC; America For Sale by Jerome Corsi, PhD.

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