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FORECAST FOR 2013

If the end of 2012 is any indication, then the commercial real estate market is certainly on the upswing. Was the increased volume of commercial real estate transactions because of the fear of the fiscal cliff or a sign of things to come? It was likely both.

While the increased activity in the commercial real estate market at the end of 2012 and the rush to close deals before December 31st can be attributed to the threat of the fiscal cliff and the potential tax consequences, which all were anticipating, it also showed that there are deals to be made and investment opportunities worth pursuing.

In all likelihood, the growth will not continue at the rate we experienced at the end of 2012. Recovery will be slow, but will most likely continue. Because new construction has been somewhat stalled over the past several years, apartment, office, industrial and retail vacancy rates appear to be on the decline. This drop in vacancy rates has led to increases in rents and if the demand increases, it could also lead to new construction.

Since the "Great Financial Recession" began, investors have been cautious about where to allocate their capital. Now that the market has shown slow but somewhat steady improvement, investors are more inclined to allocate that capital to real estate assets. We have seen this primarily with our private equity and investment fund clients, who were holding onto their funds or investing in other markets, but now they have turned their focus back on the real estate market. This renewed interest in the real estate market can be attributed to the income-producing possibilities and potential for a greater rate of return based on the recent showing of increased rents which has been brought about by decreased vacancy rates.

In addition, because last year was an election year and the fiscal cliff was looming, many investors were extremely cautious regarding their overall investment strategies. Now with the election behind us and the fiscal cliff averted, at least for now, investors may be willing to make long-term planning and strategic decisions, knowing there will be another four years under the Obama Administration.

The commercial mortgage-backed securitization market also started making a comeback near the end of 2012, and although the threat of the fiscal cliff loomed, the desire for yield over less risky bonds seemed to outweigh the fiscal cliff concerns. Considering commercial mortgage-backed securities (CMBS) are delivering higher yields than those offered by U.S. Treasuries or other forms of government backed investments, the resurgence of the CMBS market should continue into 2013, resuming the confidence behind commercial real estate assets remaining strong.

With interest rates holding steady at all time lows, mezzanine loans have also once again become attractive to senior lenders and borrowers. While many senior lenders generally continue to cap their loan-to-value ratios at no more than about 70%, mezzanine debt has once again become necessary to complete many deals. The lower interest rates on first mortgages has made it affordable for borrowers to obtain mezzanine financing and attractive for senior lenders to deploy capital without selling off interests.

While there are a number of positive signs in the economy,
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it is reasonable to assume that 2013 will be a year of transition with plenty of uncertainties remaining in the markets in general. Many companies will continue to be cautious on expanding their business until they know the full impact of the implementation of the Affordable Care Act (“Obamacare”), which will take place in 2014. Likewise, the current deficit spending of the Federal Government is simply unsustainable. At some point, the Federal debt ceiling and other related issues will need to be addressed and it remains to be seen how the

resolution (or lack thereof) of those issues will impact the economy and the commercial real estate market.

One of the lessons we learned from the fiscal cliff is that the market is always forward looking. We make decisions today based on how we think the outcome will be tomorrow. While there is reason to be optimistic about the commercial real estate market, there is much ahead of us that will undoubtedly bring unease and uncertainty in the financial markets.

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