Commercial real estate slump flagged as threat to recovery

BY JOHN MORRISSY, FINANCIAL POST; CANWEST NEWS SERVICE JANUARY 14, 2010

Crumbling property values in U.S. commercial real estate could derail economic recovery and send North America into a double-dip recession, warns the chief executive of real-estate services company Avison Young.

Mark Rose makes clear he expects employment growth and expansion of the North American economy to lay these worries to rest. His 2010 National Forecast, released Wednesday, calls for another depressed year for North American markets, but an eventual recovery in commercial real estate.

Yet without companies hiring more people to occupy U.S. office, industrial and retail space burdened by double-digit vacancy rates, the issue "could be explosive."

"I absolutely believe that there could be a very, very serious problem," Rose said in an interview.

The issue is that these properties, selling at peak values in 2007 and often purchased with large amounts of debt, have now fallen in value by 40 to 50 per cent. It is a situation similar to the U.S. residential real estate market, in which subprime lending eventually left property owners with much more debt than equity in their homes.

In a normal market, those commercial properties would likely have been foreclosed on, Rose said.

But "due to government intervention, the concept of distressed selling and buying did not materialize anywhere in North America. The U.S. government put money into the major banks, which in turn extended every loan they could to avoid realizing losses.

"The Securities and Exchange Commission watched from the sidelines and allowed the impacted lenders to postpone the inevitable.

"Before recovery can occur in 2010," Rose added, "private markets must solve their own problems, even if that means capitulation."

With trillions of dollars of public and private funds tied up in the sector, capitulation -- meaning lenders finally recognizing their losses -- would likely lead to "six to 12 months of significant pain.

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"We're going to have bankruptcies, people are going to lose their jobs. Selling those assets at fire-sale prices will impact the rest of the economy and the rest of the industry," Rose said.

"I think if we're going to see either another dip or a collapse, it's going to happen somewhere between now and the summer. If things start to improve, I don't think we'll see any of it."

In any case, it will be a challenging year in the U.S., one in which "significant progress is not projected," said Earl Webb, president of U.S. operations for Avison Young, which describes itself as Canada's largest independently-owned commercial real estate services company.

Canada's commercial real estate market also faces another tough year, but is at least poised for more rapid recovery than that of the U.S., the report said.

The financial crisis and recession that accompanied it drove up vacancy rates in Canada across several commercial asset classes, including office space (up 270 basis points to close out 2009 at nine per cent) and industrial space (up 110 basis points to 6.3 per cent), Avison Young said in its 2010 National Forecast.

As well, investment sales plummeted, with transaction volume down 55 per cent to $5.4 billion through the first nine months of 2009.

But the market "appears to be weathering the downturn thanks to relatively sound, though shaken, market fundamentals," Rose said.

"2010 is shaping up to be more of the same, but with a slightly positive bias."

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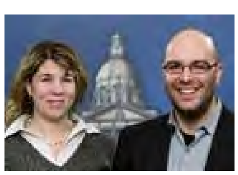

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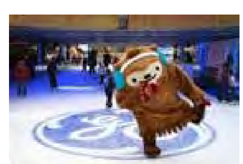

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