



Capital Metes and Bounds

By James M. Murphy, CMB, CRI

Where's The Bottom and Why Be Optimistic?

Franklin Delano Roosevelt in his first inaugural address to the nation stated: “This great Nation will endure as it has endured, will revive and will prosper. So, first of all, let me assert my firm belief that the only thing we have to fear is fear itself—nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance.”

It is now in vogue to talk about the current economic recession in terms designed to frighten the public. The purpose behind the rhetoric could be called at best disingenuous and at worst Machiavellian. There is always a scintilla of truth to the speeches but it does seem that the real agenda is to move us ever closer to a government controlled economy. This would not be so troubling if the government would only display some sense of fiscal responsibility, but instead elected officials on both sides of the isle are indeed choosing not to “waste a crisis.” We now speak of billions in the same fashion that we used to speak of millions and we are told that the pork in the current proposed budget amounts to less than 1%. The fact remains that 1% is billions of dollars. We are apparently going to address education, healthcare and global warming in one fell swoop. The best course would be to follow the advice of a famous professor at the Kenan Flagler Business School of North Carolina and “Keep the main thing the main thing.” All focus should be on the economy.

We speak of a government healthcare program while the nation’s unfunded commitments in Medicare and Social Security benefits, which now make up approximately \$43 trillion of our \$56.4 trillion federal financial burden, continue to grow at a rate of up to \$3 trillion per year. When has the government demonstrated the discipline to manage this? The fact is that our system does not reward our Senators and Representatives for saying, “no” so instead they continue to borrow more and more against our children’s future in order to satisfy constituent demands. Meanwhile, Hobbes’ Leviathan continues to grow. We propose to pay for all of this with additional taxes on the wealthy, but mostly by mortgaging the future with debt. Those of us in commercial real estate understand that debt eventually comes due but our Congress ignores it, seemingly willing to pass it off as a problem for the next administration.

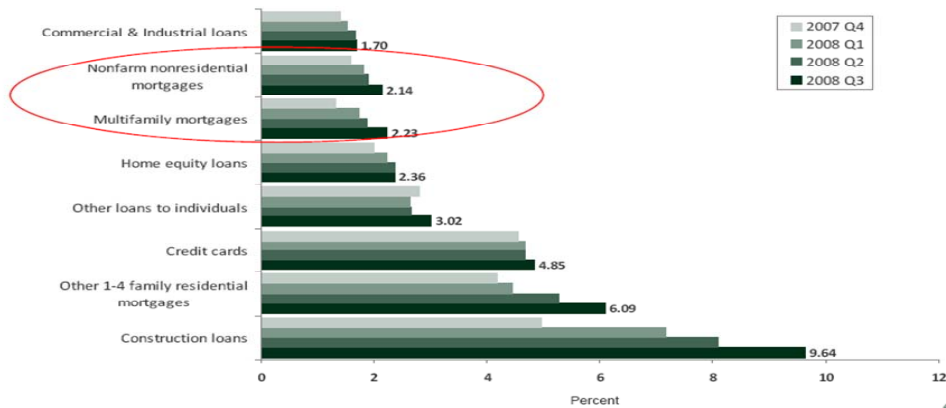
As Abraham Lincoln said: “You cannot keep out of trouble by spending more than your income” and “You cannot establish security on borrowed money.”

It does appear that fear has gripped many of us and the result is in fact as Roosevelt said: “nameless, unreasoning, unjustified terror which paralyzes needed effort to convert retreat into advance.” Capital markets are frozen, value is not discernable and the price of everything is in decline so we wait for the turn and husband cash.

In spite of all of this, there is cause for optimism. The four charts below indicate why.

First, the thirty day delinquency rate for commercial real estate and multi-family loans is less than most other asset classes.

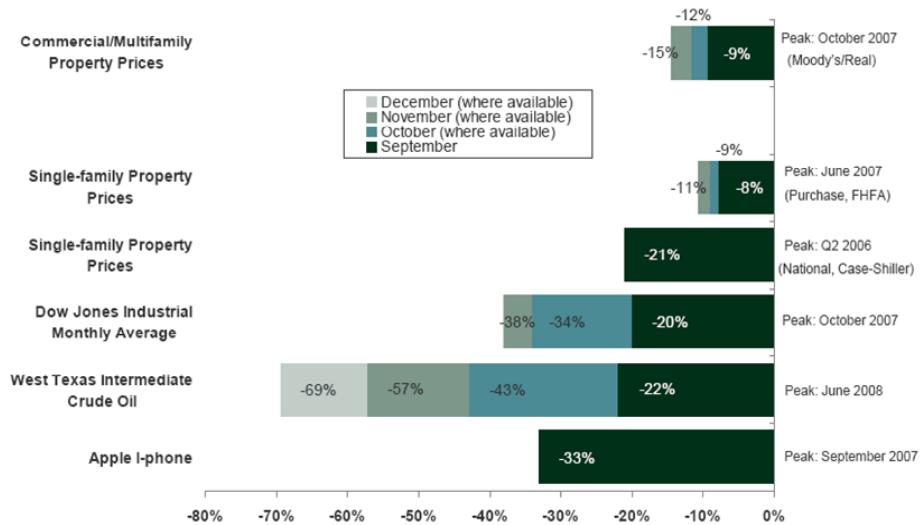
Bank 30 Day Delinquency Rates by Asset Classes



Source: FDIC

Second, commercial real estate as an asset class has experienced the least decline in value when compared to most any other asset.

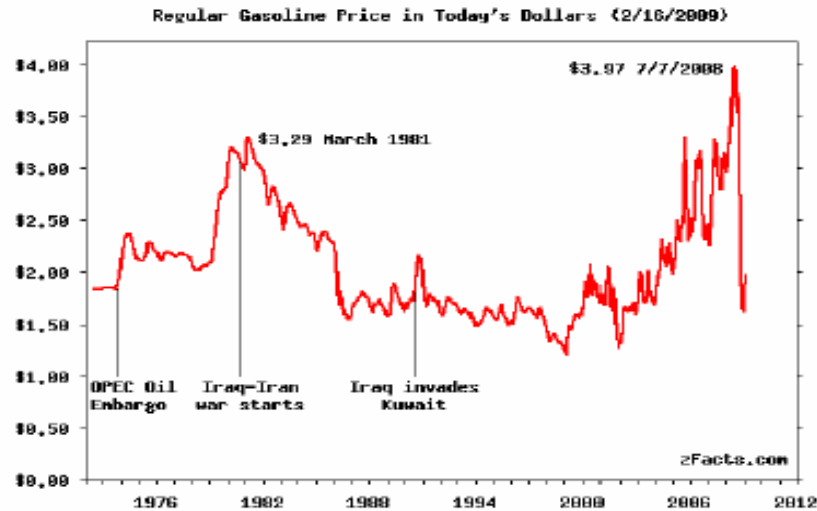
Commercial Real Estate Compared To Other Assets



Source: MBA, Moody's/Real, S&P, OFHEO, Wall Street Journal.

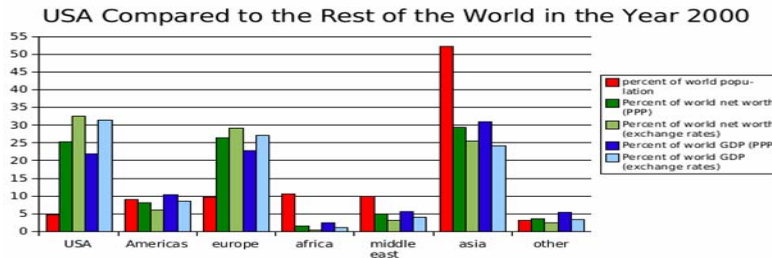
Third, the recent decline in the price of gasoline is a bigger tax break than anything the government has offered and amounts to well over a \$350 billion increase in disposable income for consumers.

Current Gas Prices and Price History



The graph reflects DOE's weekly survey (Sources). The changing gas-price widget at the right reflects daily data, mostly from private surveys. Enter US as the "State" to see the current US average price.

Lastly, the United States continues to account for over 30% of world Net Worth and world GDP when adjusted for exchange rates.



For those of you that continue to wait for refinancing, please read the advice below from one of our exclusive correspondents in the Life Insurance Industry.

“Allianz Team:

We need to highlight two event risks which may have a dramatic impact on life company commercial mortgage lending in 2009:

First we are in a "Treasury Bubble" with a risk of higher long term Treasury rates. If the economy continues to weaken and credit spreads stay wide, we could see coupon rates rise above capitalization rates to a level where positive leverage is no longer obtainable.

Second, as seen during this past week, life companies are experiencing credit rating downgrades. S&P announced last month it will be "stress testing" privately placed commercial mortgages held by life companies and expects further downgrades as a result. This could further reduce the number of life companies actively making loans and increase the likelihood those who remain will burn through their allocations prior to year end.

Given these potential event risks we have been encouraging borrowers to pull the trigger NOW if they have loan transactions that pencil. “

-Wendell Kurtz Managing Director Allianz of America, Inc.