

PANDORA'S BOX HAS BEEN OPENED



Ward S. Caswell

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In the face of a down market, it is helpful to gain some long-term perspective. Perhaps it will suffice to reach back to the lessons of the ancient Greeks as we consider the current situation. Overall commercial real estate has fared far better than residential over the past year. Households are overburdened with debt, and suffering from falling hous-

ing prices and rising interest rates on adjustable mortgages. Meanwhile corporate profits have remained high and a falling dollar has helped increase the prices for American products. Vacancy

rates for office and industrial space fell in 2007 as absorption outpaced construction. Now commercial real estate is at the crossroads as the problems of the consumer catch up with business.

Office and Industrial vacancy rates turned in the beginning of 2008 and are slowly beginning to rise. Construction levels, while small compared to the booms of prior cycles, are now outpacing demand. The trend is expected to con-

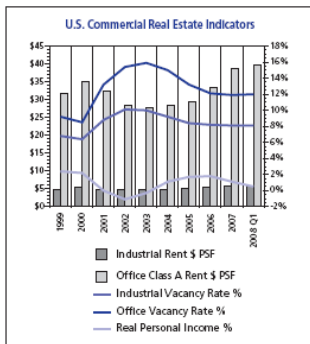
tinue and rental rates will eventually level out and then fall as a result, although in most U.S. markets rents are still rising.

Which Way to Forward?

The threats to the economy are many including rising energy prices, debt markets in disarray, likely tax increases, a lingering war, flat household income, and decaying retail spending. Still, there is hope in the form of low fed based interest rates, low unemployment rates, emerging industries, and healthy corporate balance sheets. While the consensus is that we are in a recession, there are many plausible scenarios for a short and shallow downturn. We can also learn from the Hindu Gods. Economists have a habit of using the phrase "on the other hand" when seeking to explain a situation. Durga was a powerful goddess with



Durga Image used with permission from The Metropolitan Museum of Art.



Sources: Colliers International, Bureau of Labor Statistics

many arms and perhaps embodies the views of economists. Clearly some of these forces have a stronger influence over the economic future. Employment growth, income and consumer spending outweigh the rest and merit close scrutiny with each monthly release and revision.

The reasons for our view are clear. It is important to remember that the last two downturns were largely brought about by the fiscal policies of the Federal Reserve to stave off inflationary concerns. This downturn however is brought about by a collapse in confidence, and consumers who are unable to wring further spending from their income or credit. With real wages largely static over the past twenty years, the expansion has come instead from debt as consumers were given access to credit not as readily available prior to the 1980s. With savings rate effectively at zero, consumers have borrowed from the future to fund their current comforts. The reasoning is sensible enough as individuals see increases in their earnings over their careers; they assume they will be able to pay off the debts incurred today.

What's In the Box?

Free flowing availability of capital also fueled the run up in commercial real estate pricing. Global cash flows, cross collateralization, securities packaging, derivatives, and other vehicles created a Pandora's Box of complexity in the debt markets. Warnings came about the lack of transparency as it became increasingly difficult to follow the threads of ownership and commitment. That ended somewhat

abruptly in August of 2007. It was then of course that collapse of a few institutions triggered a virtual shutdown of the global credit flows. The Pandora's box, that was the overcomplicated debt markets opened, releasing fear, failure, and great losses. But hope remained. In my opinion, hope springs from the realization that problems in the credit sector have slowed the real sector a bit but not crippled it.



Painting of Pandora by John William Waterhouse
1906 oil on canvas

"But the woman took off the great lid of the jar with her hands and scattered all these and her thought caused sorrow and mischief to men. Only Hope remained there in an unbreakable home within under the rim of the great jar, and did not fly out at the door...But the rest, countless plagues, wander amongst men; for earth is full of evils and the sea is full."¹

In the Greek myth of Pandora, hope was considered a sin, the only torment not to escape the box created by Zeus to punish man for stealing fire. It may seem strange to think of hope a sin. Hope is so often touted as something to

be praised. Some even campaign for the Presidency on the concept of hope. What would be a sin if the deception and greed that filled the box escaped and seriously and negatively influenced ordinary people's lives. For the prudent investor, hope is indeed as much a sin as it was to the logic loving ancient Greeks. For hope is a desired outcome without the underlying guarantee of deliverance. Hope is all that remains after poor planning leads to an uncertain outcome.

For the prudent investor in hospitality real estate however, there is something better than hope; there are credible forecasts based upon good data, solid, tested techniques, and the skills of those who ply them. When you have PKE, who needs hope! At Colliers International we are proud to be working with PKF to help our clients make decisions based upon facts and solid execution, rather than just hope. In times like these, that's a much better plan.

Notes:

¹ Anne Baring and Jules Cashford, *They Myth of the Goddess: Evolution of an Image* (London: Penguin Books Inc., 1982) 516

Ward S. Caswell is the Chief Research Officer for Colliers International. He is located in the company's Boston office where he serves the strategic global interests of the organization. Ward holds a BS in electric engineering from Tufts University. He was the winner of the Diggle Award for the creation of the Commercial Information Exchange (CIE) within the Open Standards Consortium for Real Estate (OSCRE) and was also instrumental in launching the Real Property Unique Identifier (RPUID), a registry of commercial property for the purposes of facilitating easier matching of disparate property relevant data sets.