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**EXCLUSIVE**

# Which Macro Events Could Most Impact CRE

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Siegler: "These days, if China catches a cold, many companies and countries could catch pneumonia."

SAN DIEGO—From high **housing debt** to global uncertainty, there are many global issues that could deter **commercial real estate**, San Diego-based **Pathfinder Partners**' senior managing director and co-founder **Mitch Siegler** tells GlobeSt.com. In part 1 of a two-part story, as he prepares to speak on a panel about macro events that may impact CRE investing in the coming year during the **IMN Forum on Real Estate Opportunity and Private Fund Investing** in Laguna Beach, CA, next week, we spoke exclusively with Siegler about which events will impact CRE the most. Stay tuned for part 2, in which we will discuss with Siegler how these events could impact CRE and how his firm takes these events into account in its business dealings.

***GlobeSt.com: Which macro events—e.g., oil prices, rising interest rates, the presidential election—do you think might most impact commercial real estate in the near term?***

***Siegler:*** 2016 is likely to be a year of many inflection points, much change and high volatility—and that's before we talk about the election. The world is more interconnected by the day, and the current environment could change in a heartbeat, so stay nimble. Here are the tailwinds and headwinds I see for the year ahead.

**Tailwinds:**

***Mortgage rates remain at historic lows*.** While the **Fed Funds** rate is expected to rise a bit, historically high spreads and futures markets suggest that **mortgage** rates will remain quite low for at least the next year, which should continue to make **housing debt** highly affordable.

***Gasoline prices remain extremely low.*** The price of unleaded gasoline is now just $1.99/gallon on a national basis—on an inflation-adjusted basis, it's around $.26/gallon—about as low as it's ever been. Super-low gas prices have given consumers a shot in the arm, though they've generally chosen to save rather than spend the windfall. The flip side is trouble in the oil patch—up to one-third of energy producers have heavy debt loads that they can't service at $50-a-barrel oil, let alone at today's level of about $30 a barrel.

***Employment is strong.*** The **unemployment** rate has declined to about 5.1%, and until recently**job** creation, has continued to be solid with more than 290,000 jobs created in December. There may be a few storm clouds on the horizon as the manufacturing sector appears to be cooling, which, combined with the strong dollar may start to crimp exports and export-related jobs. Also, the headline unemployment rate doesn't tell the whole tale, since millions of Americans remain in part-time positions or have become disillusioned with their prospects for finding a job and have left the workforce.

***The US consumer is in a pretty strong position.*** The average household savings rate is 5.5%, up from a low of just 1.9% in 2005. Households have steadily repaired their balance sheets since the**Great Recession**. There are multiple signs of solid consumer confidence including record auto sales of 17 million for 2015. That said, car sales for the year ahead are unlikely to continue to rise.
**Headwinds:**

***The market for rental housing remains tight.*** Occupancies are 95%-plus, and rents have grown 3% to 5% per year in many cities for the past several years. We're forecasting more of the same in 2016 because the massive decline in the US **homeownership** rate has caused millions of households to shift from owners to renters. Very few **apartments** were built from 2008 to 2012, and though we see lots of cranes in many US cities, those new **apartment developments** are barely keeping pace with new household formation. The supply-demand imbalance benefits property owners and crimps renters, many of whom are spending 30% to 40% of their household income on rent.

***Household debt remains high.*** Consumers are saving more and paying down debt. Low interest rates make it easier to cover debt. However, household debt is still too high, and **Millennials** are struggling under the load of high student-loan debt.

***Demographic challenges****.* Many industrialized countries in Europe and Asia are experiencing shrinking populations. The US is fortunate to still have a growing population, driven by immigration and higher birth rates for immigrants. But, we're aging, and our population growth far exceeds our labor force growth—with fewer workers supporting each retiree.

***Tortoise economy.*** The **Congressional Budget Office** forecasts annual growth in the labor force of 0.5% over the next 25 years, down from 1.7% during the 42-year period from 1965 to 2007. With productivity gains increasing from recent low levels to the post-WWII average, the CBO expects a GDP (economic) growth rate of about 2.2%, which is well below the 3.3% GDP growth rate during the 40-year period leading up to the Great Recession. Interest rates are historically low for a reason—the **economy** remains sluggish, wage growth has been anemic and there's little prospect for a quick turnaround, especially in an environment where energy and commodity prices remain very low.

***Global uncertainty and volatility****.* While energy prices are low—which keeps inflation in check and allows for interest rates to remain low—the Middle East is a powder keg. Well-connected friends say it will take generations—not years or even decades—to resolve what are long-term, systemic issues. The key players in the Middle East are in the very early innings of a civil war, and the recent dust-up between Saudi Arabia and Iran could have major implications for energy and financial markets, as could the heightened terrorist threat from all sorts of bad folks.

Meanwhile, China's economy is slowing dramatically. The communist Chinese government isn't open, to say the least, so major shifts in the world's second-largest economy have profound implications for all of us. And if you think the US has issues with "have's" and "have-nots," the situation in China makes us look like we're absolutely egalitarian, holding hands and singing "Kumbaya." China does not have a true middle class, and the overwhelming majority of Chinese wealth is concentrated in the hands of just 10% to 20% of the people living in the coastal zones while the vast majority of Chinese live inland on just a few dollars per day. Another powder keg.

Let's peel back the onion and look at a specific story. Earlier this month, **Apple** just announced that it's not buying new **iPhone 6** components for the next three months because soft sales have boosted its inventory levels. About 99% of iPhone parts are manufactured in China. **FoxConn** and other Apple suppliers responded immediately by furloughing employees. China's key stock market indexes fell double-digits losing more than $1 trillion in the first seven days of trading in January. Trading has been halted on several days because selling tripwires were hit. The China downdraft has been spilling over to big declines in the US and world markets. These days, if China catches a cold, many companies and countries could catch pneumonia. Amidst all of this, wealthy Chinese continue to look for a safe haven for their money and expatriate capital to foreign countries, where they're buying real estate, particularly luxury homes. The US is probably pretty well insulated because we're such a safe harbor, but other countries and particular cities remain highly dependent on Chinese homebuyers and may feel a pinch from this.

***The Internet continues to disintermediate traditional retail****.* Spending at regional malls and **brick-and-mortar stores** was softer this Christmas. Meanwhile, online spending exploded. On Cyber-Monday 2015, Amazon fulfilled 23 million items, a 40% increase from 2014. My wife and I purchase virtually all of our non-perishable household items (toothpaste, deodorant, shampoo, razor blades, etc.) from **Amazon** – and we're not even the target demographic. We have younger friends who never go to **CVS** or **Walgreens**, let alone Target—which just fired its CEO because of continuing downward sales trends. All of this has profound implications for ownership of neighborhood **grocery** or **drug-anchored centers**, historically among the safest and most secure, virtually bullet-proof investments. In the meantime, demand is off the charts for the massive, highly efficient fulfillment centers Amazon and other fulfillment operators require throughout the country. So, it's a great time to own **industrial** real estate.

***The future of office space utilization continues to face headwinds.*** We've been talking for years about how traditional users of office space, like law firms, now use far less space because their law libraries are digitized, their word-processing departments are a thing of the past and the old 3:1 secretary/attorney ratios of a generation ago are now essentially flipped, with three lawyers sharing one paralegal. All of this means a dramatically reduced amount of space per employee. And law offices aren't alone—the same trends prevail in banks, architectural and design firms and advertising agencies. Plus, our smartphones allow us to work from home, **Starbucks**, airports, **hotel** lobbies or virtually anywhere on the road. All in all, this makes for a dramatically reduced demand for **office** space—even for the hip and cool dot-com companies with ping-pong tables, beanbag chairs and oversized cappuccino machines. Last week, I read that revenues and earnings for office furniture makers **Steelcase** and **Herman Miller** were way down in 2015—I guess fewer square feet per employee translates into lower spending per employee for office furniture.