Whether you believe a downturn in the real estate markets will arrive tomorrow or two years from now, it might be worthwhile to consult with clients about repositioning their assets. Watch for those triggers!

"If I had a dollar for every time I heard someone say 'At this point in the cycle...' I could retire," noted Roy Schneiderman, a principal with San Francisco-based Bard Consulting, which works with mega-pension plans such as CalPERS (California Public Employees Retirement System.)

That phrase turns up a lot these days from existential trepidation about where the country and real estate markets are in terms of economic cycles. Based on historical patterns, the common assumption has been for the United States to slip into a real estate recession about every 10 to 15 years. The last big recession was in 2008, so most industry folks are getting wary. The current extended growth period as of December 2019 was 126 months, which could very well signify the real estate world is at

Is A Downturn Coming?

By Steve Bergsman | Sponsored by SIOR Foundation

the tail end of the growth cycle, meaning there is nowhere to go but down.

The big, over-riding questions are when that will happen and will we be able to see the "triggers" ahead of time, giving the industry time to prepare, if companies and investors are not doing so already?

The optimists—such as John Culbertson, SIOR, founder and principal of Cardinal Real Estate Partners LLC—do not expect that some parts of the real estate industry to experience a downturn in the very near future. In fact, he gives the industrial marketplace another three years of expansion.

Culbertson lives and works in Charlotte, N.C., a city and state that has seen extensive economic and population growth over the past couple of decades—a trend line that will probably continue for at least another decade, giving him a rosier view than most.

"There is going to be substantial investment in robotics and that will call for a lot of retooling; there will be more on-shoring; a rush to Class A distribution buildings as a result of e-commerce becoming more efficient; and single-family residential will drive a lot of growth," Culbertson explains. "Industrial

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markets have a lot of opportunities ahead."

Asked if this salubrious forecast was palatable for the rest of the country, Culbertson added, "This would be true for everywhere else except in the wider Midwest, which won't see as much industrial growth."

He concludes, "I don't see anything on the horizon that would cause a serious shift in the market. There may be a few threats, but I'm not noticing a lot of true indicators."

Other office and industrial brokers are a little more cautious, scanning that same horizon for signs that could end the current expansion.

The trouble is that some instigators are not so obvious. The second-to-last very serious real estate downturn occurred in the mid-1980s. One of the hidden triggers was the deregulation of the savings and loan industry, which then moved into hyper-commercial lending. The financial side of the market blew up. Then in the '90s, the country went through both a mild-recession and popping of the dot-com bubble, which affected the real estate market. Finally, the Global Financial Crisis of the mid-2000s, was again partly caused by aggressive expansion on the financial side of the industry, with vast increases in the securitization of real estate investments that needed more real estate to fill its offerings.

Brokers like John A. Mundell III, SIOR, first vice president of investments, national office and industrial group of Marcus & Millichap Investment Real Estate in Detroit, Mich., are being much more cautious. As he notes, "Myself, my team, and my company are sensitive to what might trigger a slowdown or some sort of recessionary activity."

Considering the last recession, Mundell is looking at such data points as a housing collapse, illiquid activity in equity and debt markets, decline in manufacturing output, record high debt on households, and a drop in consumer spending.

"We are seeing a couple of those triggers in regard to manufacturing where we are reporting the lowest factory output in 17 years; the way that the Federal Reserve is justifying the lowering of interest rates, despite the fact that the economy is still in a significant growth mode; and household and consumer debt, which is at an all-time high," Mundell says. "Those are all potential triggers that should be watched."

On the positive side of the economic ledger, Mundell lists: the harmful impact of the government's tariff policy has been delayed; corporate payroll taxes are healthy; the Fed continued to lower interest rates, boosting home and business spending; low inflation; historical highs in the stock market; high consumer confidence; strong lending environment; and an upcoming election that should postpone difficult economic decisions.

Asked when he thought a real estate slowdown might happen, Mundell guessed in 2021 or 2022.

Nevertheless, to be on the side of caution, some of his recommendations to clients would be to:

- Review savings habits: put money into reserves for a rainy day.
- Refinance into longer-term instruments or away from recourse loans.
- Complete capital projects for repair or improve the property to best position for the future.
- Review loan covenants.
- Look at recession proof investments, i.e., in medical, food or military real estate.
- Internal review of assets, both fiscal and physical.
- Consider positioning assets for sale, especially those in hot markets.
- Some investors might want to consider moving off the coast and into the Midwest for more favorable cap rates.

- Those investors in two or three markets might want to consider a wider geographic spread of assets.
- If investors decide to hold through the next cycle, they should consider refinancing in this low-interest rate environment.
- Landlords should review rent rolls and develop a strategy to maintain cash flow even through asset devaluation, market downturn, or national recession.

Given the stage and the length of this cycle, owners should strongly consider assessing values to determine core equity through the hold period, says Mundell. “If you have achieved objectives, it would be a good time to sell and have liquidity for the next downturn. For those who choose to hold, look at tenancy and assess risk, such as with companies that promote co-work space. A strategy for bringing incubator services in-house is a good play.”

Unlike the last recession, the commercial real estate industry has not experienced intemperate growth with vast over-building or over-leveraging as a whole, Mundell concludes. “Banks and other lenders appear to have maintained their conservative underwriting as compared to the last downturn. During this cycle, REO (real estate owned) and CMBS (commercial mortgage-backed securities) defaults have been kept at a minimum.”

“Human nature, though, predicts that as investment demand continues, these standards may tend to slide, allowing for future lending risk,” says Mundell. “These, among many other triggers, are an important litmus test as you look toward the future as to whether a recession is on its way.”

Culbertson has his own set of portents that would indicate a real estate downturn ahead, including financial institutions turning very conservative, markets becoming frothy, and inexperienced investors making big bets that don’t seem to make market sense.

If those ol’ recession blues come rolling around again and real estate markets suffer, Culbertson says to just hang tough by focusing on client relationships, including doing some tasks that might not result in immediate compensation, over-deliver, use technology to become super-efficient, and find ways to remain upbeat so as to continue to be creative.

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> **[F]ind ways to remain upbeat so as to continue to be creative.**