NEW ENGLAND REAL ESTATE JOURNAL

Friday, January 30, 2004 THE LARGEST BUSINESS PUBLICATION OF ITS KIND IN THE NATION

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Economic development isn't like nuclear physics; it's more like common sense

As the economy slowly picks up and retailers total up their performance over the recent holiday season, a concern arises among investors: will this positive mood translate into increased costs of capital for 2004, and more precisely, how much and how soon? Many experts now predict that the recovery will be a slow climb since there are a lot of idle resources to be absorbed, thus the escalation of rates will be slower then some fear.

The unemployment rate dipped down at the end of 2003, but this may only have been a seasonal employment spike. Currently at 5.9%, the level of unoccupied work force could be considered a healthy level of turnover. Unfortunately, many predict it will likely rise again until employers start hiring as a part of longer-term expansion to meet slowly increasing demand. This phenomenon has given rise to the phrase "jobless recovery". Productivity soared in the last year as a result of more wide spread use of technology and perhaps overworked employees, dedicated in the post-layoff environment to long hours and smaller bonuses. Once profits climb and the public gets comfortable with the thought of profitability, the productivity situation should attract new investments and result in new hires, justified by the climbing bottom line. Towards the beginning of the third quarter, the majority of resources should be absorbed, producing an unemployment rate closer to 5.5%. Confidence in a lower jobless rate by year-end is bolstered by expected election year hiring incentives.

Improvement in the real estate market beyond the healthy residential sector is already apparent in retail, but the industrial and office sectors are still showing spotty results. While there are still significant vacancies in many markets, several larger cities seem to have bottomed out and turned the corner. How this recovery will directly impact real estate remains a mystery as conflicting economic forecasts from credible sources attest.

Our review of many reports indicates that the 2004 capital costs forecasts tend to project a gradual increase in interest rates, but no major spike. Thus, while we have all enjoyed the historic low rate environment in the past 18 months, an improving economy seems to be a fair trade off for slightly higher costs of capital.

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