RECESSION WATCH

Transportation Reform in the Limelight

Mid-June was a big time for transportation, with the House leadership and the Obama administration proposing differing approaches for how to proceed with legislation and funding.

In the House, U.S. Representative James L. Oberstar (D-MN) outlined his transportation reform package on June 18 and called for immediate markup of a full bill in subcommittee. A day earlier, Secretary of Transportation Ray LaHood asked Congress for a quick 18-month highway reauthorization to replenish the Highway Trust Fund. Long-term reform should wait, he said. "We should not rush legislation. We should work together on a full reauthorization that best meets the demands of the country."

Oberstar's proposal, Blueprint for Investment and Reform, calls for moving away from prescriptive programs into a performance-based framework designed around national objectives. Programs would be consolidated and simplified into four core formula categories—repair/maintenance, highway safety, surface transportation, and congestion mitigation/air quality. Oberstar would also create four new programs—metropolitan mobility and high-speed rail programs, an Office of Livability, and a new transportation infrastructure bank.

Oberstar calls for total funding of $450 billion over five years, a significant increase from current funding levels, with an additional $50 billion for high-speed rail. He does not address where new revenues will come from; the funding issue "will be resolved in the Ways and Means Committee," he said.

RACHEL MACCLEERY is managing director of ULI's infrastructure initiative group.

U.S. CITIES LOSE OUT?

"We have a long history of shortchanging cities and metropolitan areas and allocating transportation money to places where few people live."

—Owen D. Gutfreund, an assistant professor of urban planning at the City University of New York and author of *20th Century Sprawl: Highways and the Reshaping of the American Landscape*, referring to how although two-thirds of residents in the United States live in large metropolitan areas, cities and their surrounding regions are getting far less than two-thirds of federal transportation stimulus money.

From "Cities Lose Out on Road Funds from Stimulus," by Michael Cooper and Griff Palmer, *New York Times*, July 9, page A1.

Commentary: Looking Ahead to the Next Development Opportunity

Times are tough for just about all players in the real estate world today, but are particularly difficult for developers. Not only is it extremely challenging to land lead tenants for viable projects, but also construction financing is virtually nonexistent, even with tenants in hand. There also have been anecdotal reports that some lenders have defaulted on projects underway, stopping funding in the midst of construction to reevaluate the economics of the deal and attempt to shore up rocky balance sheets.

Despite the severity of this recession, it is important to remember that the U.S. economy has gone through worse and not only survived, but thrived. The country is in the midst of the longest, deepest recession since the 1930s, but as hard as it is to fathom, the population and job base in the United States will grow over the long term. As this growth occurs, opportunities for developers will follow.

Remember, recession is the exception: quarterly job losses have only occurred about 15 percent of the time in the past 70 years. Eighty-five percent of the time, the United States adds jobs. If we believe in future job growth, real estate demand then becomes a question of when, where, and how much?

Demand is only one side of the equation; viable development opportunities must also be considered in the context of competitive supply. After all, it is the intersection of supply and demand that ultimately determines occupancy and rent levels. Here, the lack of construction financing today is a good thing because very little new supply will be delivered to the market as the economy starts to get back on track in 2010–2011.

Given the severity of the recession and record or near-record lows for completions over the next 18 to 24 months, the pieces are in place for a massive fundamentals cycle. Record-high vacancy rates over the next year will give way to unprecedented vacancy rate declines in outer years.

Of course, not all markets are created equal. To home in on the best opportunities for future development, consider the following variables for screening markets:

▷ **Net demand.** Markets with the largest forecast demand growth relative to forecast supply growth will enjoy the strongest rebounds in rents and occupancy levels.

▷ **Relative forecast vacancy rate.** Robust recoveries are one thing, but even quickly falling vacancy rates may remain high in some markets. This variable will measure how close each market's average forecast vacancy rate is to its long-term average.

▷ **2007–2009 supply growth**. High construction costs and long approval processes prevented construction activity in many markets from ever ramping up before the credit crunch and recession hit. Other markets had quite a bit of construction, leaving plenty of new projects ready to soak up demand when it recovers. This variable will allow differentiation between these two types of markets.

▷ **Time until rent growth.** This variable is measured in quarters and addresses the issue of when rent growth will return.

▷ **Exit pricing**. Which markets will see liquidity and price stability come back first? A proxy for this can be created using relative expected cap rates in the middle of 2012 because properties breaking ground next year will deliver into this environment.

Three-Plus More Years?

"When do you think commercial real estate property values will begin increasing again?"—the first question posed online at ULI's Web page—garnered close to 300 responses. There were three choices; this was the breakdown:

One year: 14.4 percent

Two years: 39.5 percent

Three-plus years: 46 percent

Look for more polls on the Web page, www.uli.org.