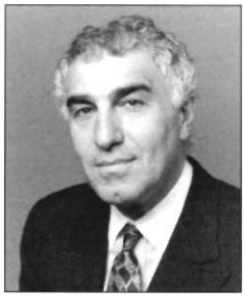
FOCUS ON THE ECONOMY & REAL ESTATE

AMERICA ATTACKED: IMPLICATIONS FOR THE ECONOMY & REAL ESTATE

by Raymond G. Torto, CRE



This perspective focuses on what the events of September 11 imply for the economy and property markets. It addresses questions such as how long to expect the recession and how deep the short-term effects will be. It also considers which property types will be most impacted.

We are in mourning for the many victims and their families. The appalling attacks are unconscionable and our country is offering our condolences, our services, and our money to help in every way.

Tragically the world has changed. Fortunately, our country has found resolve and unity. The much-needed struggle against terrorism is worldwide, fought in historically small battles with espionage and security being the predominant weapons, and where success is defined in unconventional terms. President Bush and Defense Secretary Rumsfeld have stated it will be a long and difficult struggle. We are optimistic about the outcome and we firmly believe our economy will see only temporary, albeit significant, damage.

THE ECONOMY

Torto Wheaton Research's (TWR) current outlook on the economy is dramatically different than the outlook we had in June 2001, even though that analysis forecasted significant slowing in the U.S. economy. We are forecasting a recession for the next six quarters, which will be deeper than most other analysts are expecting and a bit longer. We believe that the first sign of positive growth will be in the third quarter of 2002 indicating an end to the recession.

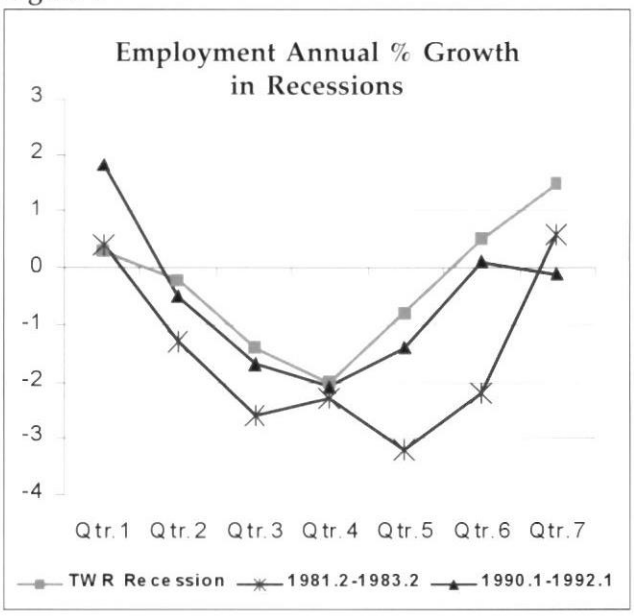
It is our expectation that September's layoff announcements will be reflected in the fourth quarter 2001 counts, which started October 1. The unemployment effects will ripple through the economy into 2002, before the pace of this recession starts to moderate. The weekly unemployment claims release of September 27, 2001, is supportive of this view. Weekly claims are up for the week of September 24, but not significantly, compared to earlier periods. We do expect these numbers to rise considerably over the next several months.

Figure 1 plots our recession outlook in contrast to the historical recessions of 1982 and 1990. The first data point in the graph is the quarter prior to the beginning of each recession. For our current forecast, the first period is the second quarter of 2001. Our forecast expects declining employment to be a –1.4 percent in the fourth quarter of 2001 and a –2 percent in the first quarter of 2002. Comparing our forecast to the previous downturns, we are expecting this recession to be less severe than that of 1982.

TWO COMMENTS ON THIS OUTLOOK

First, in the short run, we strongly advise against panic reactions and quick

Figure 1



judgments. The nation is in mourning. The magnitude is unbelievable and time is needed for all of us to return to economic activity as normally as we can. The terrorist attack of September 11 is unprecedented, but the economic effects have historical patterns that can help us analyze current markets and outlooks.

Second, we expect both an ongoing military reaction to September 11 by the United States and ongoing concern of a response by the terrorists. Further, we are expecting a fiscal stimulus package (Keynes is back!) by year-end, however, as of press time, the details have not yet been defined.

It should be noted that historically, the U.S. economy entered a recession due to the confluence of two forces. Our last recession in 1990 occurred as the Federal Reserve was tightening interest rates due to inflation fears and financial institutions were suffering a credit crunch due to real estate failures. As the economy was weakening, Iraq invaded Kuwait, consumer confidence plummeted, and the recession began in July 1990.

The 1990 recession, although traumatic for real estate professionals, was short-lived—eight months—and was not as deep as the 1982 recession. While the 1990 recession heavily impacted real estate property markets, this was not the case in 1982. The difference between the two recessions was the void of any building boom in 1982 versus a construction boom of unprecedented size in the late 1980s. Fortunately, the 2001-02 recession will affect real estate in ways similar to the 1982 recession (and not the 1990 one). That said, some property types will suffer more than others due to a mini building boom currently underway in some sectors.

PROPERTY MARKETS

The recession will impact the property markets, but real estate in general is in a better position today than in 1990. Fortunately, real estate has not created the over capacity found in many other industries. For every sector except hotels and maybe industrial, the income streams of most existing property investors have held up well compared to the alternatives.

Real estate has shown its diversification benefit over the last year and recent events have strongly endorsed its diversification role for a portfolio. The properties of many investors have occupancies above 90 percent with strong rents. These investors are in enviable positions if their tenants are credit worthy, with leases in place longer than two years. While the leasing markets for all property types will loosen significantly over the next 15 months, the 2001 recession will not be as severe to real estate as was the 1990 recession. REI

ABOUT OUR FEATURED COLUMNIST

Raymond G. Torto, Ph.D., CRE, *is principal at Torto Wheaton Research in Boston, where he specializes in market research analysis and economic forecasting. He has been a member of The Counselors of Real Estate since 1988.* [redacted]