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COMMENTARY

Commercial defaults could be our undoing

Historically, New York gets into a recession behind the rest of the nation and lags in the recovery. No surprise that the latest economic indicators state that Long Island bankruptcies are up 22% over last year. Couple that statistic with a state budget deficit of $13 billion projected to be even higher next year, and one has difficulty seeing the light at the end of the tunnel.

Particularly troubling is that several hundred billion dollars in commercial mortgages are maturing this year, with a significant number of them going into default. While high tech, service companies and manufacturing are key sectors on Long Island, the real estate market is the strategic backbone. If that sector is impaired through defaults, small and medium banks, and the regional economy itself, are at risk.

At midpoint of 2010, we are continuing to witness high vacancies and low rents, tenant bankruptcies and strict, even hostile lending policies. Traditional adversaries, banks and landlords, are now finding themselves allies since they need to jointly deal with troubled tenants in commercial and retail space.

The last thing most thoughtful lending institutions want now is more underwater property. The market is seeing renegotiated lending agreements, as pragmatism becomes the overriding business rule but the demand for these kinds of progressive resolutions is far outstripping "supply."

Washington has produced a response—the Federal Financial Institutions Examination Council has developed a set of written guidelines for "prudent workouts," which provides lenders with a regulatory primer for getting the job done. It may not be sufficient, however, to confront what is coming.

Analysts believe that the number of commercial failures could make last year's residential housing crisis a pale precursor to next year's pain. Further, there is little bandwidth left in the federal government to accommodate this growing crisis. As a result, local, consensual restructuring between borrower and lender will be essential with a team more committed to securing results than scoring tactical victories at the others expense.

The enormous government deficits building within state and local governments have no such guidelines because closing those financial gaps is about political will. Yet the consequences of a default are staggering. New York will have to cover a $20 billion deficit next year without any assistance from Washington whose earlier economic stimulus package to states was a one-shot affair.

There is also enormous concern from insiders about Nassau County's looming deficit. There are few choices other than cutting services, raising taxes or awaiting an arrival of a massive new generator of revenue.

Edward J. LoBello, a fellow member of the Meyer, Suozzi, English & Klein's Bankruptcy & Business Reorganization Group, notes that municipal bankruptcies are few, but when they do occur, they give the markets a cardiac jolt whose impact is felt on every Main Street.

Against this grim backdrop of stagnant job growth, precarious financing, reduced property values and tenant vacancies is the recognition that the economy should never surprise the business

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community. Since currency and lending was invented there have always been cycles of boom and bust, irrational optimism followed by rueful awakening. This is just one more of those cycles but it comes with a significant caveat: Long Island and New York face a twofold challenge unique to this recession. We need to create an environment that allows for rational workouts that permit our economic wreckage to be swept away with a minimum of dislocation. Meanwhile, we must use this period of time to implement new business incentives and government consolidations that ensure we have the means to climb out of this bust. Those communities that fail to recognize opportunity in the midst of bankruptcy condemn themselves to economic irrelevance and a long, slow and ultimately fatal decline.

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