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Appraisers beware: The market is changing!

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The day-to-day capital markets remain unpredictable as signs of improvement one day are shortly thereafter neutralized by volatility the next. The credit market correction we witnessed in August has induced a cooling effect on what was a record year through August of 2007 versus 2006.

According toReal Capital Analytics, the first half of the year was on track as the largest national investment volume on record with over $350 billion in total consideration of assets trading hands on a national level. This record volume was driven by a mass flux of privatization activities, most notably the nation's largest private real estate purchase in history; Blackstone's 12 million s/f acquisition of Equity Office Properties Trust for $39 billion in February. Shortly thereafter, Tishman Speyer and investment bank Lehman Brothers' announced in May that they would acquire the number two multifamily REIT in the nation, Archstone-Smith.

As a result of its timing with the "credit crunch", the Archstone-Smith acquisition received close examination by industry insiders citing increasing cost and decline availability of financing as likely factors that could potentially lead to a re-trade, or the inability for the deal to close. Given the higher cost of debt, buyers' returns have been impacted, thereby requiring them to pay less in order to achieve their return on equity.   Despite being caught amidst the credit market turmoil, Tishman Speyer and Lehman Brothers were successful in their acquisition and closed in October for a total of $22.2 billion demonstrating that strong institutional assets, run by quality operators, and positioned in well located markets are able to overcome the debt market challenges.

While overall sales volumes have declined around the country, rents in many markets continue to rise, and the fundamentals in real estate remain strong. According to the U.S. CRE CDO loan delinquency index, delinquency rates on U.S. commercial real estate loan collateralized debt obligations are reaching "historical lows," mirroring U.S. commercial mortgage-backed securities.The default rate for commercial mortgage-backed securities is about 0.4%, compared with a 20% default rate for subprime, or high-risk home loans, that represent the hardest hit segment of the residential mortgage market.

Additionally, foreign investors continue to buy more commercial real estate as a result of the both the weakening U.S. dollar and the perceived softening of U.S. real estate prices. New York City has traditionally been the target entry market to the U.S. for many oversees buyers, but with the average office deal exceeding $200 million, many foreign investors have turned their sights to other coastal office locations offering similar high quality, well-leased, real estate in cities such as: Boston, Washington D.C., Seattle and San Francisco.

The fear that we have not seen the worst of market conditions looms ahead. In a worst-case scenario, hedge fund collapses will lead to the distress of lenders and the all-around tightening of loaning practices. If the financial sector put a halt on available debt, this would impact even the strongest of companies, such as Procter & Gamble or IBM. From this perspective, it is not unforeseeable that the previously contained capital markets crisis could bleed into the general economy creating job losses, stock market dips, declining home values and a general recession.

The issue at large is that "risk was mispriced on an extensive basis globally" stated Jerry Grantham, chairman of investment company GMO. Investors are becoming cognizant of the fact that the risk-reward ratio was stacked unfavorably against them and are now demanding more of a return for their sub-prime mortgage and poorly-rated bond backed security ownership. The result has been a large-scale repricing of risk across all asset classes, ranging from mortgages and highly ranked corporate debt to junk bonds and office and building equity.

The role of the real estate appraiser will become more important as we navigate through these market times, both on the residential and commercial valuations. In these times, the more experienced and educated appraisers that are designated by the Appraisal Institute will be the leading professionals that will effectively handle the important and difficult assignments moving forward throughout 2008.

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