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Valuation counseling and underwriting

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The same analytical methodologies for commercial real estate are applied in appraisal and underwriting. At the annual meeting in Philadelphia on October 19th -22th, the counselors listened to the rate makers in the market and at least one familiar methodology for making sense of the market. Counselors and other real estate analysts are finding challenges in reconciling the spectrum of expectations in the market. Mark Zandi, chief economist for Moody's Analytics, ended his remarks "Struggling To Hit Escape Velocity" with his forecast of 5% for GDP for 2013 and acknowledged most of his colleagues expect GDP to drift in the 2-3% range through 2013. With significant disparity at the macro level among respected economists, no one should be surprised at the range of disparity at the micro level for commercial real estate.

Counselors Peter Korpacz and Richard Marchitelli in their discussion of "How to Appraise Property in a Depressed Market" talked about the familiar methodology of the survey technique, emphasizing systematic, thorough, serious data and opinions. The established image of the national investor survey, developed by Korpacz and continuing to carry his name, provided a mental shortcut for most if not all in the audience. Ed Glickman CEO of Pennsylvania REIT discussed current market for riskless investments, high yield bonds, commercial real estate loans and term dynamics on cap rates. For many, the pattern of market rates and expectations resulting from a systematic survey of market participants provides the framework, enhanced by other benchmarking rates and data, to forecast the micro market for commercial property in a depressed market. Some critical caveats were offered by all three panelists including, prominently, to select the appropriate buyers and sellers for the property being appraised or analyzed, presumably those participants with demonstrated interest in the submarket.

Underwriting investments will use most of the same property and market data used in the appraisal process. However, the forecast can and often does include divergent components that will distinguish the outcome. The disparity between the bid and the ask in commercial property markets continues to limit availability of capital and velocity. The survey technique can provide some helpful data points for the counselor or appraiser appraising in distressed markets where transactions are limited. For investors underwriting properties, the survey questions and the participants might be marginally different to illuminate the market trends which are consistent with the investment strategy. Rather than managing data, the analyst illuminates the market, and develops a credible analysis by providing appropriate data using a recognized methodology to bridge the gap in transaction activity.

On Monday October 27th the U.S. Treasury sold $10 billion of five-year Treasury inflation protected securities, or TIPS, with a yield of negative .55%. The negative yield was a first ever at auction although the yield on many TIPS in the after market has been negative. The investor interest and pricing results from increasing inflation expectations which will provide positive inflation protection investments. At negative .55% for the five-year, the implied inflation rate is 1.7%, the difference between regular Treasury yields and TIPS or the break-even inflation rate. Can we use this? I like the sound of 5% better! Both are benchmarking data that are useful in clarifying the prevailing murkiness in the market.

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