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The replacement factor impact individual properties

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The real estate counselor should consider the replacement factor in recovery and expansion phases of the economic and real estate cycles. Replacement factors impact individual properties and overall competitive inventory in all property categories. Economic contractions can brutalize rental income receipts. Defensive strategies often include slow to no replacements of short-lived and occasionally major components of the physical improvements. These impacted assets often do not recover competitive market position and slip slowly or suddenly from the inventory. Depending upon demand and absorption, the replacement of these ultimately abandoned improvements can help to stabilize the markets.

Ray Torto, CRE global chief economist for CBRE sat down with the New England and Upstate New York Chapter of The Real Estate Counselors on February 3rd after the last snow blast that collapsed some roofs in the Commonwealth. Replacements were not on the agenda specifically but his comprehensive market update included some relevant references to the market dynamic. He used a sailing starting line metaphor to characterize competitive capital reaching deeper into risk spectrum during 2011. While capital crowded the windward end of the line on starboard tack for core investments during 2010, the capital fleet will be settling for riskier investments along the line off the mark, and some might well try port tack from the leeward end of the line or elsewhere to avoid the starboard crunch to windward. Further, not all boats will rise with the tide as the markets continue to improve with the broadly forecast job growth and economic gains in 2011. Also, CBRE adjusts competitive inventory based on anecdotal information from its extensive brokerage community.

Replacements have tightened the box for underwriting and appraising the NOI. Additional reserves for replacements, allowances for fix-up, tenant improvements, other rent-up expenditures restrict loan-to-values, loans, and cash-outs if any. Although adjustments in competitive inventories because of extended cash-strapped holding periods can often be gradual, the counselor can observe the rent and pricing patterns by a thorough analysis of the inventory. Torto often describes his perspective at 13,000 feet. However, his brokerage network provides ground level observations that enhance the credibility and the quality of his outlook.

The starting line is set once again and winning strategies will be numerous. The replacement factor will be important to remember in commercial property investment and market analysis. The greater Boston market and many markets with vintage inventories have survived and thrived in replacement cycles with historic preservation and adaptive reuse. Less dramatic reinvestment in the wasting inventory has enabled a wide variety of pricing and quality for start ups and lower marginal employment. The two-handed counselor can win, too. Just be careful and considered in this recovering marketplace.

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