



CELEBRATING
55 YEARS

nerej

The current economy is like a horse in barbed wire

December 08, 2011 - Appraisal & Consulting

According to my husband Bob, the current economy is like a horse in barbed wire. For those who have not spent much time in the equestrian world, a horse that steps in barbed wire freezes, refusing to move for fear of injury. From my perspective, this metaphor hits the nail on the head especially when applied to the real estate sector.

During the course of performing our professional duties, appraisers analyze market data and determine what is referred to as market value. Market value in a nutshell is defined as the amount a willing and informed buyer is willing to pay for and what a willing and informed seller is willing to accept for a property. Herein lies the problem - this amount is often worlds apart between buyer and seller, hence the paralysis in the marketplace.

Many sellers have a minimum acceptable price in their heads for their property and refuse to budge. This minimum price is often based on the amount the seller has invested in the property as well as the mortgage payoff. No seller wants to go to a closing and have to lay out money. Most buyers are looking for a bargain and are willing to wait on the sidelines until they get that bargain.

This impasse is the result of uncertainty. Real estate decisions are based on future expectations. A family buys a house with the expectation that with every mortgage payment, not only will the principal be paid down, but also equity will build up. This is a great strategy if housing prices are stable or increasing, but if housing is a depreciating asset, renting is a better option than ownership. And what happens if the home owner should lose his or her job and cannot afford the mortgage payments?

A similar situation exists for the investor in commercial real estate. Most investors are looking for a positive cash flow from their real estate investments. When a purchase of commercial real estate is made, the investor makes projections assuming that the occupancy and rental rates will be stable or increase. But in the current economic climate, there are no guarantees concerning occupancy and rental rates. Tenants are very aware of this factor and have used this as a negotiating point for lower rents.

In addition, expenses typically have increased for the property owner. Utilities and real estate taxes are two line items that are almost guaranteed to increase annually. Lower income and higher expenses do not bode well for the bottom line.

All this uncertainty has had a particularly significant impact on the value of developable land, considered to be the most risky of all real estate. No developer/investor is willing to pay top dollar for

land when so much uncertainty exists in terms of when the investment will turn a profit. When will all this uncertainty end? Every economist has his or her own answer to this question. Some are predicting another recession due to the European debt crisis. Others forecast not until all the jobs lost in the Great Recession are replaced. Still others guess not until after the next presidential election. The only consensus is that the end is not any time soon.

Pat Amidon, MAI, is president of Amidon Appraisal, Portland, ME.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540