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Presidents message: The appraiser vs. meteorologist

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There is a lot of symmetry between real estate appraisers and meteorologists. Many of us watch with disdain as the weatherperson on television appears excited, almost gleeful about the prospects of a pending nor'easter. In much the same way, appraisers these days appear energized and excited about storms brewing in the real estate markets. Now, neither the meteorologist nor the appraiser truly wants a bad storm or a down market. However, both want to get the forecast right and that starts with a proper analysis of a multitude of data.

In the case of appraisers there is such a wide array of data available it can be difficult to always get it right. Mainstream newspapers and Internet media, in my opinion, tend to report the extremes of market conditions. A story about markets in equilibrium is boring and would likely not even be written. However, a story about real estate prices crashing and foreclosures rising at unprecedented levels makes a better read. This is not to say that market conditions are not down. In many cases they are, but it varies greatly among the various sectors of the real estate market.

On January 22nd the Mass. chapter of the Appraisal Institute held its annual "Economic and Market Outlook" program at the Federal Reserve Bank in Boston as a means of asking market experts about their expectations for the coming year. This year's experts included Lisa Campoli of Meredith & Grew, Michael Prakken of CBRE/Melody Capital Markets, Timothy Lyne of CB Richard Ellis New England, and Brian McKenzie of Richards Barry Joyce & Partners. These panelists provided attendees with an overview of local, regional, and national real estate markets from several perspectives, focusing on the suburban and downtown Boston office markets as well as a review of current capital market conditions.

Here is a summary of their take on current conditions in the local office market, and where it appears to be going.

From a forecasting standpoint, certainly the office market is the most challenging sector of the commercial real estate market these days. From 2003 through 2006 the fundamentals of this market were generally lackluster. Both the downtown and suburban markets still had double digit vacancy rates and lower rental rates that had yet to recover from the dot.com crash of 2001. However, despite this, the demand to purchase office properties, particularly trophy properties in both downtown and the suburbs skyrocketed. A glut of investor equity and capital chasing a limited supply of deals drove cap rates down to historically low levels.

However, for the past 6 to 8 quarters, the fundamentals of the office market have improved significantly. The overall Boston office vacancy rate is 6% as we begin 2008 and the average asking rent is up 36% from one year earlier according to CBRE. But just as the fundamentals began to catch up with investor enthusiasm, the "credit crunch" hit in the summer of 2007. Now, investor enthusiasm is waning and according to several of Boston's top brokers the commercial real estate investment markets, including the office sector, is paralyzed. Here is what to expect in 2008:

- * Sales volume will be down sharply in 2008 vs. 2006 and 2007.
- * Class A rents will stabilize while class B rents will increase modestly.
- * The financing markets will present challenges, even roadblocks to some of the new construction proposals.
- * Underwriting standards will be more stringent.
- * Upward pressure on capitalization rates caused by the credit markets will be offset by a rise in net operating incomes as a result of the better fundamentals discussed earlier.
- * Values will hold for core assets in primary locations.
- * Values for properties in secondary locations will likely decline moderately from their early 2007 peak.

The Mass. chapter of the Appraisal Institute will host more two-hour luncheon events in 2008 at which experts will share their opinions on market conditions in the various sectors of the local and national real estate market.

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