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# These are challenging times to appraise - 7% capitalization rates and other tall tales

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Our firm appraises a variety of commercial property types throughout New Hampshire. We recently received an elaborate package for a proposed refinancing for a moderate sized shopping center located in a secondary market. While the center was almost full, there were no credit anchor tenants, the center included a walk-out basement level and the center was located along a corridor with only moderate traffic counts and no access from the east due to a natural barrier. This package valued the property using a 7.25% capitalization rate with comparables supporting this rate.

When I questioned the assumptions for this valuation, I was told "It's a good-looking center." When I discussed other centers that sold recently at 8+ cap rates, I was told, "It's a perfect 1031 exchange". In other words, no support for this kind of capitalization rate was going to be coming.

As an appraiser, these are challenging times to appraise commercial properties. Many sellers and their representatives, are still aggressively pricing their product, especially if it is a property at full, or at least high stable, occupancy. For investment properties, the pricing would be much higher than projected replacement costs. Yet while the pricing remains high, the actual number of closed transactions that we have seen is lower than one year ago. If the property is "cash-flowing," then there has been no great incentive for the seller to cut prices further.

Monies remain available for new acquisitions or refinancing for commercial real estate. For a property in a secondary location, one lender quoted me 150-200 basis points over LIBOR with a 1.25 debt coverage with a 20-year amortization. Non recourse, if available, is needed to be competitive.

While I do not see capitalization rates climbing to the 10% levels for most property types, the 7% rate remains available only for the investment grade properties of which there are few and far between in northern New England.

For properties that are part of the typical owner-user market, there is a different story. The amount of supply, especially oriented to the small business owner, would appear to be much higher than one year ago and some price decreases have appeared.

The office market in particular seems to have softened in the last six months. Occupancy rates have decreased in most market and rental rates are showing a decline. While the official unemployment rate remains low, there just does not appear to be much of job creation that creates demand for office space.

I have not seen decreases in rents, or increases in vacancy rates, for most retail developments. I have even seen space that has been vacant for years in southern New Hampshire be filled once the asking rents reach reasonable levels. Many owners should say thank you to the new poker rooms and many payday lending stores that now seem to be multiplying.

The amount of new construction for commercial uses is much less than one year ago. For new construction, I have compared pricing to one year previous and construction pricing does not appear to have shown any increase due to increased competition for bids.

The condominium market in northern New England is extremely depressed when compared to the levels of previous years. For example, in Manchester, the sales rate has shown a 28% decline from 2005 to 2007. With the current number of listings, there is a six month supply while the average listing price is 20% greater than the average sale price in 2007. There is obviously some disconnect here.

The single family market has also seen declines in values, I am not able to quantify these declines as we have not been asked to appraise any single-family subdivisions in the past eight months which is a statement in itself. The one property type that we've often been asked to appraise is vacant residential land. Currently, the market is extremely limited for potential sellers.

The one buyer that is available, and with ready cash for residential land, are the conservation commissions of many communities in New Hampshire that are flush with monies from current use penalties that have been paid over the past few years. I know, as an appraiser, that there can be pressure on this type of assignment as the sellers hope that you rely on sales from previous years. The challenge is trying to find recent sales for this property type.

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