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Attention to risk analysis will enhance real estate investment

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Commercial real estate risk is a unique combination of market and operating risks and liquidity (lack of liquidity) risk which has traditionally afforded real estate investments distinct risk premiums enhancing investment yield and overall returns. One-off (single-property) investments are subject to the local forces in supply and demand and the equilibrium or disequilibrium in the related submarket inventory. Most commercial real estate is management intensive requiring professional marketing and asset personnel and specialized skill sets. Liquidity in the market for commercial real estate and related interests has traditionally been risky and certainly varied by geography, property type and size. Plentiful capital and improved technology for orderly diligence and auction have enhanced liquidity. Updating basics and underwriting risks have increased order in the markets and mitigated risks.

Favorable fundamental economic conditions are stabilizing for commercial real estate markets. Macro-economic outlook for the nation and generally most regions is for gradual and continuing economic growth. Local micro economic growth particularly related to local job and income growth as drivers for demand for commercial real estate varies widely in the geographic and property submarkets. Market supply and demand fluctuate as the local economy and additions to supply roll forward. Aggregations of inventory and changing characteristics are timely and widely available improving transparency. Primary research on market conditions and gathering of anecdotal data are still essential to underwriting.

Operating risk assessment is more diligence and vigilance, mostly primary research. Operating data is generally available for comparative analysis and forecasting. However, commercial real estate is management intensive and hands on for all property types at every scale. Improved monitoring skills and reporting systems do add transparency enhancing efforts and results. Primary research on capacity and competence of operating management for many investments which retain management can be a routine and can be consumptive depending depth and breadth of personnel and track record.

Capital markets continue to favor commercial real estate with volume, variety and increasing sources resulting from yield and moderate economic fundamentals. Credit availability and affordability has enhanced liquidity and in many markets propelled volume. Measuring and comparing historic return rates from debt and equity markets and ratios for the capital stack in related transactions can bracket the liquidity risk. The increasing volume of transaction activity can inform better underwriting and forecasting of commercial real estate performance.

Traditional risk analysis in commercial real estate investments is both basic and complex. Current core components in risk are as they have been, idiosyncratic. Technology enhancements in properties have forced obsolescence in the older inventory. Commercial property is typically not commoditized. Dependent on demand derived from jobs and income, property performance is derived from macro and micro analysis. Attention to risk analysis will enhance the sustainability commercial real estate investment as an asset class.

Ready for the warm weather.

David Kirk, CRE, MAI, FRICS, is principal and founder of Kirk & Company, Real Estate Counselors, Boston.