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Market conditions: Be objective despite the doom and gloom

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The effect of the economy on property value has been an intriguing component of every assignment these past few months. Each segment of the market, residential or commercial, has been affected, and in most cases in a dramatic and negative way. Studying the economic conditions requires research. Each day is a new headline of doom and gloom. Major banks in trouble, stock markets hitting a new low, updated bailout plans calling for yet more spending resulting in increased federal debt and higher deficits. The decline of economic conditions in the United States continues to have a profound effect on the global economy and international trade has suffered. The reports in New England and the Northeast region of the country are also not good with the loss of jobs and a lack of new construction, both residentially and commercially, during the past year with few projects planned for 2009 and beyond. The state of the economy in Mass. has gone from bad to worse with governor Patrick requesting a substantial increase in the gas tax to raise revenue. Mayor Menino is feeling the pinch and for the first time in a decade may find himself with competitive opposition come election day. Smaller cities and towns are reeling from the cuts at the federal and state levels and without aid find themselves cutting services and laying off municipal workers including teachers, firefighters, and police.

For residential assignments a new addendum, Form 1004MC has been developed to better report market conditions and how they pertain to a specific property. The importance of market conditions on commercial assignments is no less important. The development of the cap rate in the income capitalization approach is directly impacted by the investor's reaction to economic conditions. As investors experience higher vacancy and rate losses and a decline of tenant demand for available rental space, the expectations of those future benefits are diminished resulting in higher cap rates.

As is the case with every assignment, an individual case study may not bear out the trend. I am completing a report today on a small strip mall in my area. The anchor tenant is a thrift shop that has thrived in the down market. The non-profit business accepts donations from individuals for clothing, furniture, household accessories, and books. The items are then sold to the public at attractive rates and the profits are distributed to local charities. The individual donors are able to take a tax deduction for their charitable contribution and the non-profit operates without any direct cost of goods sold. In this case the "recession proof business," eager to stay in the current location, has extended the term of the lease at a rate $2 higher than the average rate in the complex. Contrary to the trend, given this set of circumstances, the capitalization rate was not negatively impacted by the weakened economy.

Admittedly, cap rates are increasing in most segments including warehousing, retail, and professional office space. With many consumer price indices declining due to deflation and a contracted economy, rents adjusted annually by the CPI will be reduced rather than increased. What is the effect of lower rent revenues? You bet, higher cap rates.

As for the residential assignments, the new Fannie Mae requirements will be effective April 1st. The MBREA is now offering a 7 hour seminar, approved for 7 hours of continuing education by the states of Mass., N.H., R.I., Vt., and Conn. The course instructor is Anthony Federico, RA and I can tell you first hand, the course is both informative and entertaining. Check out the MBREA website at mbrea.org for details.

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