Avery Associates

Real Estate Appraisers – Counselors

282 Central St.
P.O. Box 834
Acton, MA 01720
Tel: 978-263-5002
Fax: 978-635-9435
www.averyandassociates.com

ARE WE THERE YET?

Jonathan H. Avery, MAI, CRE

The floodwaters have subsided, the weather has warmed up and tenant showings are beginning to occur more regularly. It is a good time to take a look at the experts' opinions and indicators in the market to gauge where we are in the aftermath of a tumultuous two-year period for real estate.

It was in the spring of 2008 that we first began to feel the rumblings affecting the financal and the property markets. The question of the day is, "Have we reached bottom or are we still in a declining market environment?"

Recent commentary provided to the *Korpacz Real Estate Investor Survey* provides indications, from participants in this well-respected survey, that we may have reached bottom. Comments from survey participants include such things as "…we very much sense that the bottom is near, if not there, for well positioned properties" and "…on the lending side there seems to be more willingness to get money out - particularly among life insurance companies." This sense of optimism (realism) is important to gauging where we are in the cycle.

As noted in the survey, the average overall capitalization rate has increased from 6.87% (mid 2007) to 8.42% in the latest survey. The change from last quarter is the first decrease, although only 7 basis points, since the peak in 2007.

Clearly, the survey participants express some caution, in particular it is noted that underwriting assumptions continue to be "appropriately cautious" and "…pricing issues between buyers and sellers are beginning to ease." Furthermore, the delinquencies in Commercial Mortgage Backed Securities have spiked to a figure of $65.2 billion at the end of November. At the same time, the default rate for commercial property mortgages has nearly doubled from 1.6% in 2008 to a 15-year high of 3.8% in 2009, according to the FDIC. Most Korpacz survey participants still believe that "…an increasing number of forced sales will occur over the next two years as both lenders and owners have difficulty with insufficient cash flows, declining vacancies and changes to more conservative underwriting standards for re-financing".

In terms of the local market, it is clear that office vacancies are approaching historically high levels in the suburban markets and uncomfortably high levels in Boston. Current Boston vacancy rates for commercial office space are in the 15-18% range (depending on the survey) and it is clear that suburban vacancy rates are nearing 25% .

The local brokerage community appears to be of the majority opinion that the Boston vacancy rates are more manageable and they are optimistic in the 1-2 year time frame that recovery will become evident. There is less consensus on the time required to solve vacancy problems in the suburban markets, particularly the Route 495 market. Estimates for recovery in this office sector range from 2-5 years. There are even some opinions which indicate that the components of the existing stock of office buildings (built in the 1970's and 1980's) may be functionally obsolete and will require demolition and replacement.

The bottom line appears to be a building consensus that, at least in the office market, we are approaching the bottom. The question remains as to how long we may bounce along the bottom of the trough before increasing economic and market conditions signal the beginning of a solid recovery.

Stay tuned.

Published April 2010

Real Estate Consultant Column
New England Real Estate Journal