nyrej

Overall rates and cocktail party conversation

March 26, 2012 - Financial Digest

When I'm at a cocktail party and someone finds outs I'm an appraiser one of the first things they ask is "How's the golf game?" Ah yes! Isn't life great to be an appraiser? Honestly, I only play 7-8 times a year because of the work load. Very rarely do I break 100 anymore. It's difficult when at least once a round I'll have a double digit score on at least one hole. A few years ago I shot an 11 on a par 3 and 14 on a par 5 hole in one round and still shot 117. The other 16 holes were respectable. At an appraiser event at Turning Stone Casino a few years ago I lost 16 balls in 18 holes. It was a tough course! My conclusion is that if I really wanted to play a lot of golf; I should get a real job like President of the United States. On a more serious note, I do get a lot of cocktail party questions about "cap rates." Many people have told me I should "get a life!"

We are going through the lowest interest rate atmosphere in my history as an appraiser which goes back to the early 1970s. However, the market is cautious because the Federal Reserve is artificially keeping rates at low levels as a stimulus effect. Overall capitalization rates have not diminished substantially. The reason is, investors are anticipating significant increases in interest rates after 2013. Ben Bernanke, the Federal Reserve chairman, has stated that interest rates will be kept low until 2014. Some forward commitments in 2014 for high quality fully leased projects are 150-200 basis points higher than the current market. This is a strong signal that interest rates will be increasing after 2013. The same holds true when there are high interest rates. In the early 1980s interest rates were at record highs in the range 16-18%. Yet overall cap rates only increased a fraction of the hike in interest rate basis points. That's because investors realized rates were going to decrease.

Some recent commercial ground lease overall capitalization rates I've observed were 7%-7.9%. These overall rates apply to parts of upstate New York and parts of the western/central New England region. Downstate New York and the Boston region are 200-300 basis points lower in some cases. Recent limited service hotels I observed were estimated to have 11-12% overall cap rates based upon total going concern values. The reason these rates are higher than the norm is the total going concern value includes not only the real estate but furniture, fixtures and equipment (FF&E). A small well located upstate 40-year old shopping center had an estimated overall rate of 8.25%. Community shopping centers generally have predominant overall rates of 8.25-9.25%. A well located mixed use retail and office multi-story complex had an estimated overall rate of 8.25%. A suburban 20-year restaurant had an estimated overall rate of 9.25%. This included only the real estate. If the total going concern was estimated, the overall rate could have been at least 200 basis points higher. A large newer suburban class A office building with long term leases had an estimated overall rate of 7.5%. A suburban light industrial building had an estimated overall rate of 9.5%. A desirable located urban apartment building had an overall rate of 7%. Class B downtown office buildings have predominant ranges of 9.5%-10.5%. Suburban class B buildings are 8.75-9.75%. An automobile dealership property had a overall rate of 9%. Mobile home park overall cap rates are in the predominant range of 8.25-9.25%. An A/R downtown office building has an overall cap rate predominant range of 8.5%-9.5%. Of course these overall rates apply to parts of upstate New York and western/central New England region. To repeat; large metropolitan areas like Downstate New York and Boston have overall rates as much as 200-300+ basis points lower in some cases.

In summary, interest rates and cap rates definitely move at different speeds. How's that for some cocktail party conversation? Maybe I should "get a life" and play more golf!

John Rynne, MAI, SRA is the president and owner of Rynne, Murphy & Associates, Inc., Rochester, N.Y.