



Overall capitalization rates are surprisingly low in the Rochester market

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Overall capitalization rates are surprisingly low in the Rochester market because of historic low interest rates, increasing loan/value ratios, and generally more availability of financing. Many of the community and regional banks are getting more aggressive in the commercial lending market. As an example, a large community lender has recently entered an already crowded commercial financing market. Although overall rates have been decreasing, values have increased very modestly. The reason is vacancy and some expenses had been increasing. This decreased net operating income increases. Although vacancies have diminished recently, there have been some rent concessions needed. As long as interest rates remain low overall capitalization rates will remain stable given the current supply and demand for space.

The low interest rates are forecast to remain low for the next few quarters. The Federal Reserve reportedly will be buying up \$600 billion of U.S. treasury bonds in order to maintain low interest rates over the next year. This short run strategy will attempt to attract businesses to this cheap money to expand, innovate and increase employment. The downside is that the printing of money supply by the feds will reduce the value of the dollar and set the stage for inflation. Already, some of our allies such as Brazil and South Korea immediately responded negatively because it will fuel inflation in their countries. In addition, the recent election which resulted in the 2011 takeover of the House of Representatives will further encourage business to expand. Under the current Congress, small and large business was reluctant to invest because of the uncertainty of a nonbusiness friendly Congress.

The Rochester Region has had a relatively stable real estate market because it never has had substantial oversupply of space. This will not change any time soon. According to a survey completed by CoStar Group Inc. U.S. commercial real estate under construction is down -55%, -49.3% and -48.3% for industrial, office and retail respectively between August, 2009 and August, 2010. This is an improvement over the previous year between August, 2008 and August, 2009 in which the decrease in commercial real estate under construction was approximately -70%, -50%, and -60% respectively. Although the Rochester area numbers have not been as dismal, the trends still have been down significantly. The good news is that the current supply is being slowly absorbed, which will create the need for more product. I know of a proposed rental townhouse project in the Rochester market which was at the verge of breaking ground four years ago. However, the market conditions softened and they put the project on hold. This well located project is getting closer to be put on the front burners again.

Because of the continued low interest rates and some more stability in net operating income (NOI), general overall capitalization rates have decreased slightly over the past quarter. Cap rates in the Rochester Region for suburban office properties have a prevalent range of 8.5-10.25%. Downtown

office properties have a prevalent range of 8.75%-10.75%. For shopping centers which are primarily in the suburbs, the prevalent overall cap rate range is 8.25-10.25%. For urban older industrial properties the prevalent overall cap rates ranges are 8.75%-11.75% and modern one story suburban light industrial/warehouse is at 8.25-10.5%. The older City apartments cap rate range is 8-11.5%. There is a wide range due to the large disparity of neighborhood income levels within the City of Rochester. Rochester suburban modern apartment complexes have prevalent overall cap rate ranges of 7%-9.75%. Obviously, the lower end of the overall cap rate range represents newer, high quality, well located projects. The apartment cap rates are the lowest rates of all property categories. For single tenant triple net ground leases, cap rates for the Rochester Region range from 6.5-9.75% depending upon the strength of the credit

In summary, record low interest rates are maintaining relatively low overall capitalization rates in the Rochester Region. However, the threat of a weaker U.S. dollar and inflation will not allow cap rates to decrease significantly but remain relatively stable with imminent increases on the horizon.

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

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540