



Outlook for the year ahead: The good, the bad and the ugly?

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I've got good, bad and not too much ugly news for 2009. The international financial crisis has permeated the entire U.S. real estate market. The good news is that in Upstate New York and most of Western New England the conservative marketplaces have resulted in diminished but relatively stable values. The diminishment of values have been due primarily to higher overall capitalization rates. The decreased values to a lesser extent are caused by some increased vacancy and credit loss and lower rents. The higher capitalization rates are due to decreased availability of credit and confidence in the market. However, this shortage of credit has been especially difficult for properties greater than \$1 million. Smaller commercial properties have been less affected. It's clear that the confidence of real estate investors has been shaken by the economic crisis.

As a political independent, I don't like to inject politics into an article about real estate valuation trends. However, the media for the last 4-5 years has perpetuated the idea that the economy was bad even when GDP growth was high and unemployment was low. This bias reporting hurt the Republican administration and congress. The media was successful in helping the Republicans lose congress in 2006 and the executive branch in November. More importantly, the constant 4-5 year media negativity softened up the confidence of consumers and the stockmarket. Thus, when some significant problems hit in the 4th quarter of 2008, the economy buckled more than it should have. Now that the Democrats have taken control of congress and the executive branch, the media will portray a much more positive outlook. This will help convince the American public that we are in recovery and the economy will get better.

Since the last quarter of 2007, there was a noticeable slowdown in real estate activity in the region. Much of the slowdown was attributed to the tightening of credit due to the early subprime mortgage crisis. Of course, the October, 2008 economic debacle took it a step further and devastated many real estate markets. Fortunately, much of our region was less severely impacted other than large transactions. As an example, in Rochester within the last year a large block of the Eastman Kodak industrial facility was purchased by a Buffalo investor. Quickly, the property was under contract to a Canadian investor for approximately 50% more than the original purchase price. Because of the lack of satisfactory financing, the deal did not close. The good news is the current owner is enthused about the Rochester area's long term light industrial/office market.

Interest rates should remain relatively low throughout 2009, which will put downward pressure on cap rates which will increase some values. Also, President Obama and congress will pass economic stimulus packages throughout the first two quarters of 2009. Regardless, property values will be increased due to the resulting increase in the availability of credit and more demand.

For properties which have substantial long term leases with quality tenants, values will continue to be near the levels of 2007 and early 2008. As an example, class A suburban office properties in smaller metropolitan areas like Albany, Buffalo, Hartford, Rochester, and Springfield will still have

overall capitalization rates in the predominant range of 8.50%-9.5%. However, for buildings with substantial vacancies and/or with low quality short term tenants the overall cap rates will continue to be significantly higher with the overall rates for lower quality, short term tenants of this property category are predominantly 9-10.5%. In good office locations of New York City and Boston, predominant overall capitalization rates are 5.5-8%. Small properties in these areas could have substantially lower overall capitalization rates.

In summary, real estate values in the region will continue to be again on the rise beginning in the second quarter of 2009 due in part to lower cap rates. For the most recent overall capitalization and other recent real estate rates, see the updated rate survey section of our website.

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