

COMMERCIAL REAL ESTATE

Will our escalating property prices ever bottom out?

At their very essence, commercial real estate values are the result of a price a buyer with reasonable motivation will pay and a seller is willing to accept. Easy enough.



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Contributing columnist

Let's layer in some complexity, however, as the previous statements assume the buyer will actually write a check for the purchase. In reality, most buyers seek financing for their buy, which sets in place an approval process

by a lender. Typically, lenders — short of Aunt Mabel who taps her trust fund for you — will require an appraisal, regardless of the size of the down payment. So if the buyer and seller agree to a price and the lender's appraisal doesn't conform, the transaction has an issue? Yes. Absent another buyer who is willing to assume the previous buyer's price but without a lender, the seller must reduce his price and the buyer must inject additional cash to bridge the gap or something in between. So, the first cause of a drop in pricing would be: the property won't appraise.

But, what are some

other reasons?

Interest rates spike

An obvious result of an increase in borrowing costs would be higher payments. Higher payments — which fewer buyers can qualify for financing — means fewer buyers, and less competition equals a drop. A spike in interest rates also could cause business activity to decline. The resulting lack of business could place less pressure on a company's need for space. With demand for space subsiding and fewer interested buyers, prices drop.

Black Swan event

Transactions generally

spike when prices are increasing or when they are falling. When prices are on the up, sellers win. Buyers score when the reverse happens. Uncertainty — I'm not doing anything until this is resolved — is a result of the Black Swan event such as a war, a collapse of student loan repayment, terrorist attacks on our soil, foreign leaders who launch a missile, a government shutdown, or a county bankruptcy — as we experienced in 1994 in Orange County.

New inventory

We've been waiting for a building spree for quite awhile. Yes, we have added some new buildings, but

we also have seen many others demolished in favor of apartments. In short, for myriad reasons — which will be left for another rant — the supply of newly constructed commercial real estate has not kept pace with the demand.

Enough is enough

Recently, we accepted an assignment to help a buyer find a new home for his business. When we started touring available choices, the buyer was disappointed at the low inventory and lack of quality buildings. Plus, the asking prices were jarring. Flash forward, asking prices have now hopped another 15 percent. Our tour last

week was met with, "Wow! How have asking prices increased that much in fewer than two months?" It dawned on me that if buyers refuse to pay the prices, which is unlikely, prices will drop.

It's akin to a giant game of musical chairs. This era of crazy money paying outrageous prices for commercial real estate WILL stop. We just don't know when.

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