COMMERCIAL REAL ESTATE

Downside for buyers in up and thriving market

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Contributing columnist

Someone wise once opined, it's a great time to sell commercial real estate, but not a great time to buy commercial real estate.

A market needs an ample supply of buyers, sellers and lenders, all operating independently yet in concert to function properly. If an imbalance exists — too few sellers for the buyers in the market or a shortage of free flowing capital — the picture is shaded in favor of the scarce.

Currently, our industrial market is up trending — great for sellers, tough for buyers. Below are a few of the downsides of an up market.

Available buildings are in short supply. Vacancy on industrial buildings is the lowest it's been since — well, ever! We state our vacancy as 2 percent — 2 of every 100 buildings are available. However, if we dissect this figure, we discover that the true vacancy — buildings without an occupant — is closer to half a percent.

You see, if a building is marketed for sale or lease while still occupied, it is counted as available. If the availability is dependent upon the occupant finding new quarters — good luck — it may not ever be vacant.

Sellers are over zealous. It seems that every deal sets a new record and is completed at a price higher than the previous deal. This robust activity causes sellers to be quite bullish.

Recently, I submitted an offer to a seller whose property is not on the market. He has indicated, however, that for the right price, he would sell. Our offer contained the "right price," but now the seller believes values have eclipsed his right price and he has a new right price. Upward we go.

Normal negotiations are impossible. Because available buildings are in short supply and sellers are over zealous, conducting a traditional give and take dialogue is difficult — close to impossible. Unless a buyer is willing to step up and accept the offering per the seller's terms and conditions, another buyer comes along who will. I've witnessed several instances recently where buyers miss out and are forced to conduct another search for their new business home.

Establishing values is tricky. As commercial real estate professionals, we are tasked with recommending values to sellers based upon recently completed transactions and currently available buildings. In an up market, a wide gap exists between the recent deals and the ones available for sale.

The intangible is how close to the gap the next round of closed deals will be. Also, appraisers go nuts. Buyers and sellers agree to a price that cannot be justified by closed sales. An appraiser must then interpolate a value using a secret matrix of appraiser magic.

Lenders are a bit goosey. Commercial real estate lenders sense our values are near the top. A loan misstep could cause an uneasy time if prices adjust downward and the amount owed exceeds the market value.

Currently, foreclosure activity is practically nonexistent, but the skeletons of 2009-2011 still haunt many lenders. Proceed with caution appears to be the credo of many who loan money on commercial real estate.

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