

HOW TO GAUGE WHAT YOUR COMMERCIAL PROPERTY IS WORTH

In virtually every case, a prospective client with a commercial property to sell or lease seeks my advice on value. Valuation of a commercial/industrial property is not an exact science. It is better described as an ART. I never went to ART school, but I did go to the School of Hard Knocks with 38 years of experience. I want to discuss that process as it pertains to the current commercial real estate market.

Only certain individuals are qualified to render opinions of value on commercial real estate. First, there are LICENSED APPRAISERS who are, at a minimum, required to obtain a certification from the State indicating they have taken a mandated course load and demonstrated competence in the field. The highest level of appraising is the MAI (Master of the Appraisal Institute). These folks have gone way above and beyond the minimum requirements to get the State certification. Banks like the credibility afforded by an MAI appraisal in their file, but they don't always like to pay for them. They tend to be more expensive than a non-MAI appraisal.

An appraisal done by a certified or MAI appraiser must meet certain minimum standards established by the industry. With that as a backdrop, I will tell you that you could hire five different appraisers to value your property and you would get five different values. In some cases, we see values as much as 20-30% apart! How could this be?

There are 3 generally accepted methods of valuing commercial real estate and most appraisals at least touch on all 3. First, there is the Market Comparison Approach to value. In this approach, the appraiser looks for similar properties that have actually sold in recent months or years and makes subjective dollar adjustments for substantive differences between the "comparable" and the subject. If the subject is 50,000 sq ft. and the comparable is 75,000 sq ft., the comparable is "better" than the subject, so dollars must be subtracted from the sale price of the comparable to make it equal to the subject. Building size, land size, age, condition, etc. are all measures of comparison that are used. WHEN the comparable sold is also a frequent measure because the market two years ago may have been worse than it is today, so an adjustment for appreciation needs to be made.

The second approach is called the Income Approach to Value. This is used when we are comparing income producing properties such as multi-tenant retail strips or apartment buildings. Since investors buy income properties based on yields or returns, appraisers will compare what is called a capitalization rate to arrive at a value. If investors are shown to be requiring a 9% "cap" rate for this type of property, that fact will typically put an upper limit of value on it.

The last approach is called the Replacement Cost Approach. The underlying premise of this approach is that no one would pay more for a property than what it would cost to build it new. This approach has fallen into disfavor in recent years as properties routinely sell way below what it would cost to build new.

An appraiser will typically consider all three approaches and make a best guess as to which is most valid. Good appraisers will gather their data by researching the comparable sales in the data bases and calling brokers like us, who are in the trenches daily, to see what is happening currently. When an appraiser from Chicago has an assignment in McHenry County, he needs eyes and ears of someone immersed in that market who can tell him what is really going on. I get calls almost daily from appraisers seeking input for their appraisals and I always make a point to help.

Commercial brokers are not typically certified to do appraisals per se, but we do written Broker Opinions of Value as a routine part of our business. These opinions look at and analyze the same market data that an appraiser looks at. We may not charge as much as an appraiser would have to charge, but the point is, we don't pull values out of the air. Our opinions are researched, backed up with current market data, and documented.

Don't hesitate to call or email me if you have a question about which approach might be best for your situation.

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