



# Capitalization Rate Analysis & Forecast

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# What is a Capitalization Rate?

$$\frac{\text{Net Operating Income}}{\text{Value}} = \text{Capitalization Rate}$$



# Example

If a building sells for \$1,000,000 and the seller forecasts the building will generate \$100,000 in net operating income in the first year of ownership, the indicated capitalization rate is 10%.

Net Operating Income  
Sale Price

\$100,000  
\$1,000,000

10% = Indicated  
Capitalization Rate



# Why is the “Cap Rate” Important?

- Allows investors, lenders, analysts, and appraisers to keep score.
  - Measures first year rate of return
  - Allows comparison of different property types
  - Allows comparison of different classes of the same property type
  - Allows comparison of rates over time



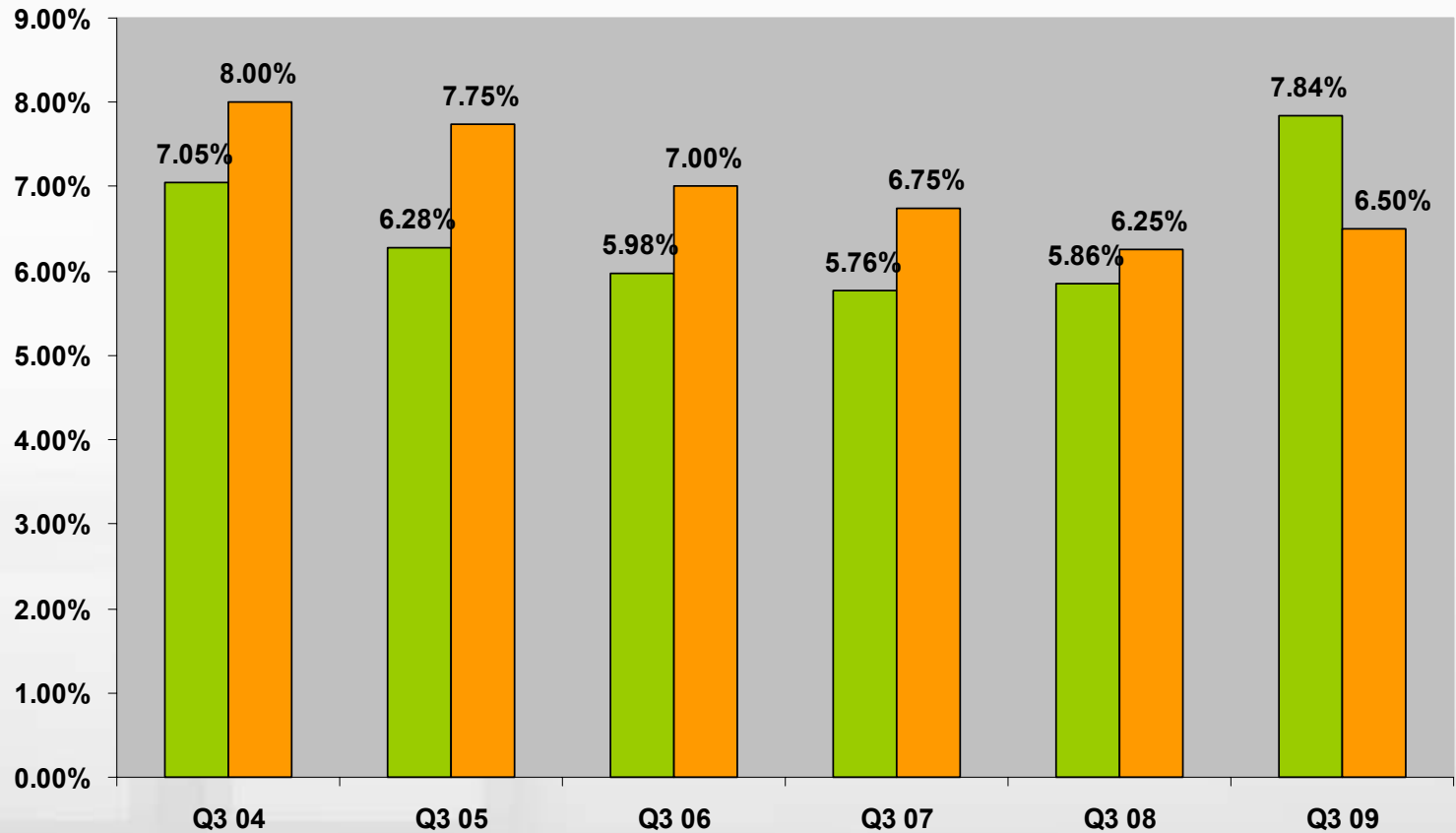
# Capitalization Rates



- Sources
  - Korpaz
  - Viewpoint
- Application
  - Class A properties
  - Well located
  - Stabilized with market oriented income stream
  - Multiple tenants





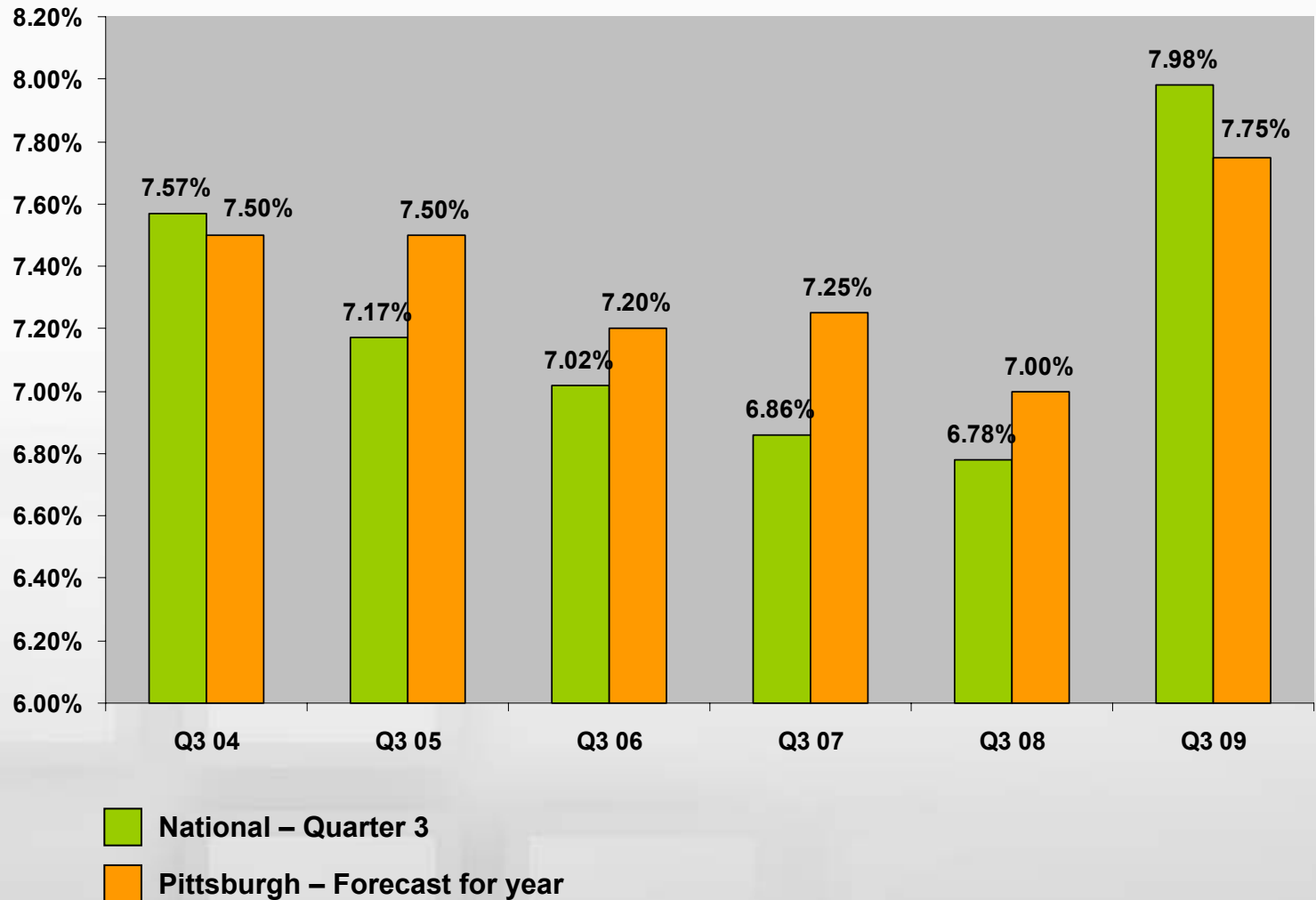
# Multi-Family



-  National - Quarter 3
-  Pittsburgh - Forecast for year

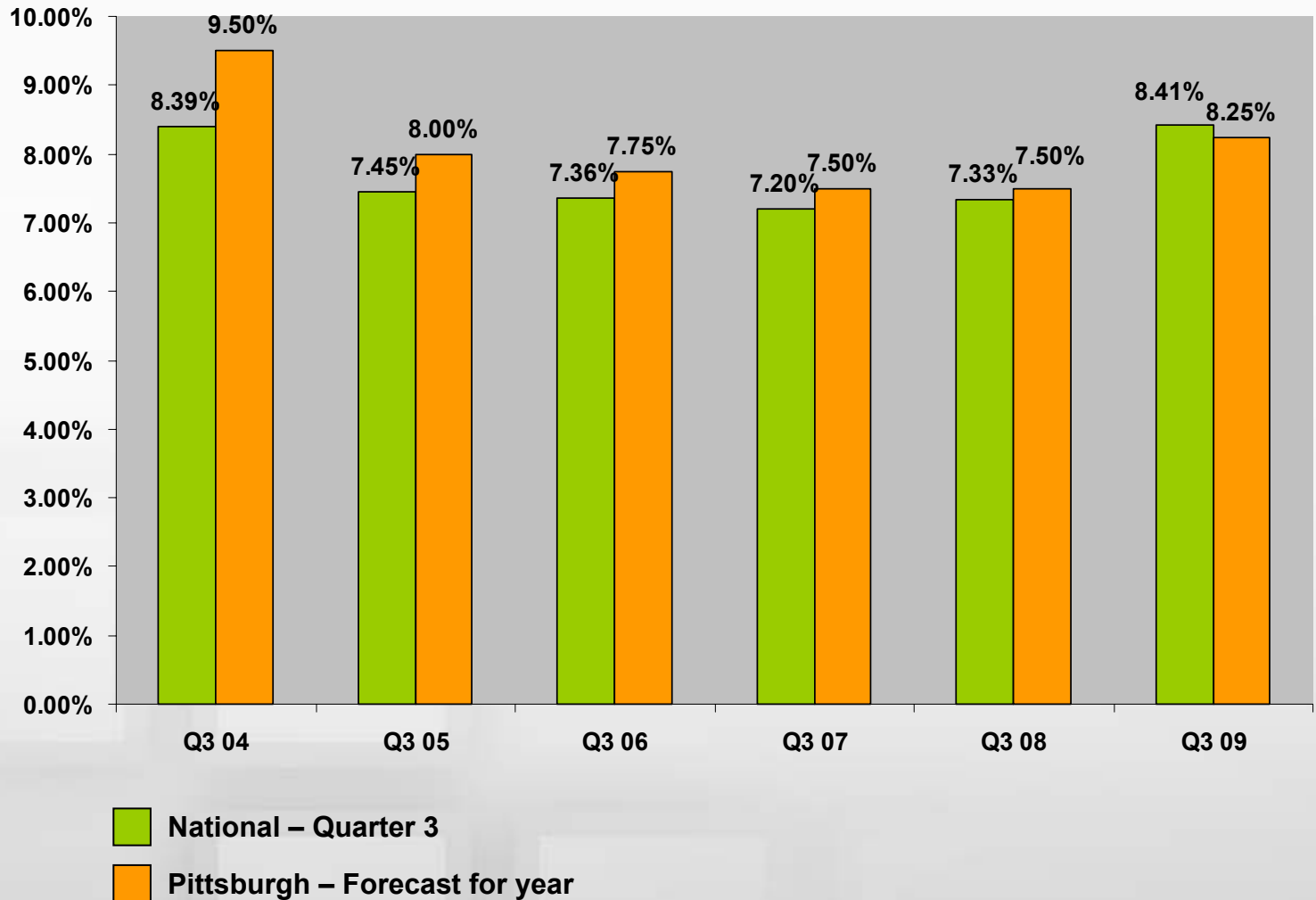


# Regional Mall



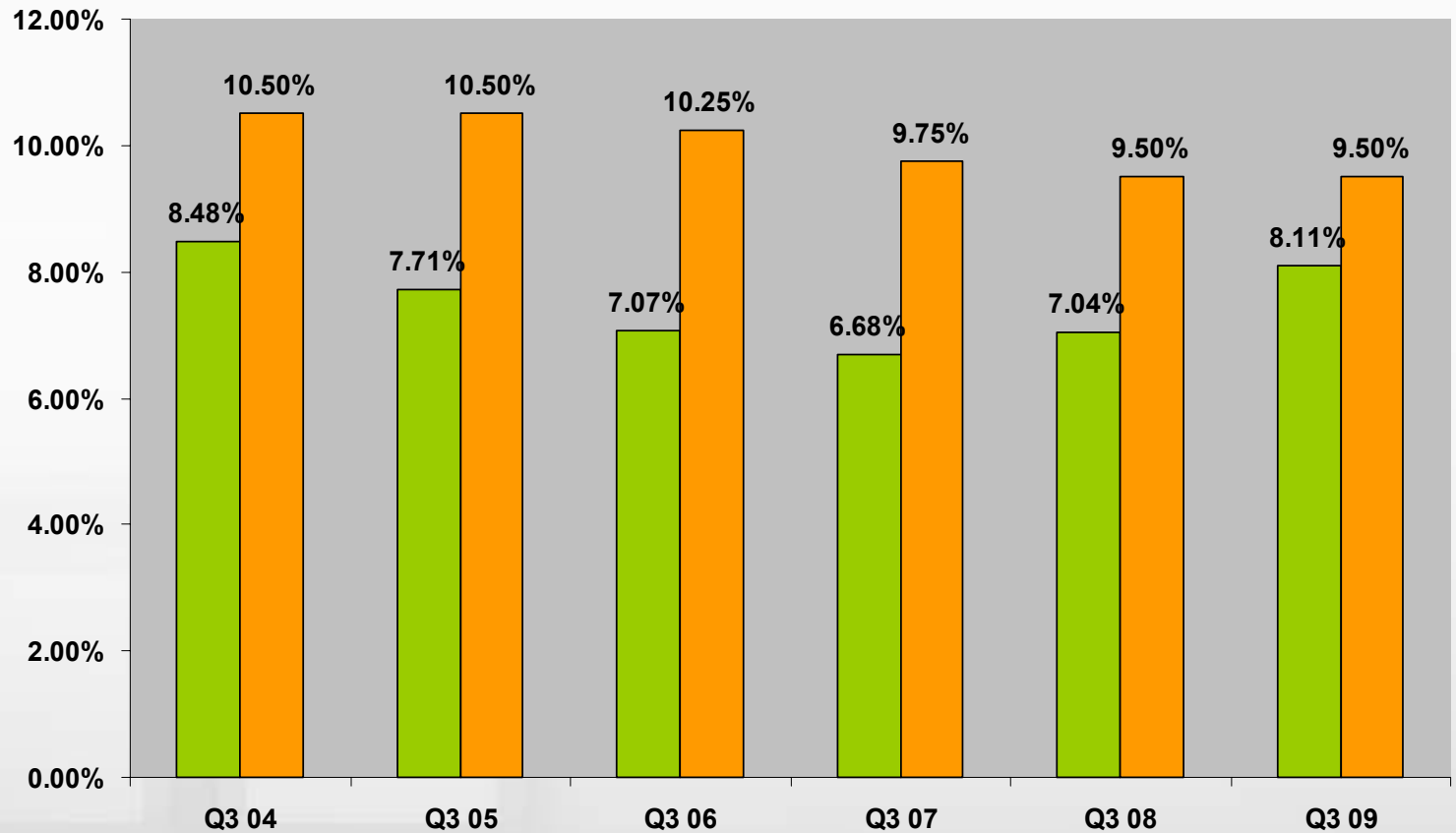




# Shopping Center



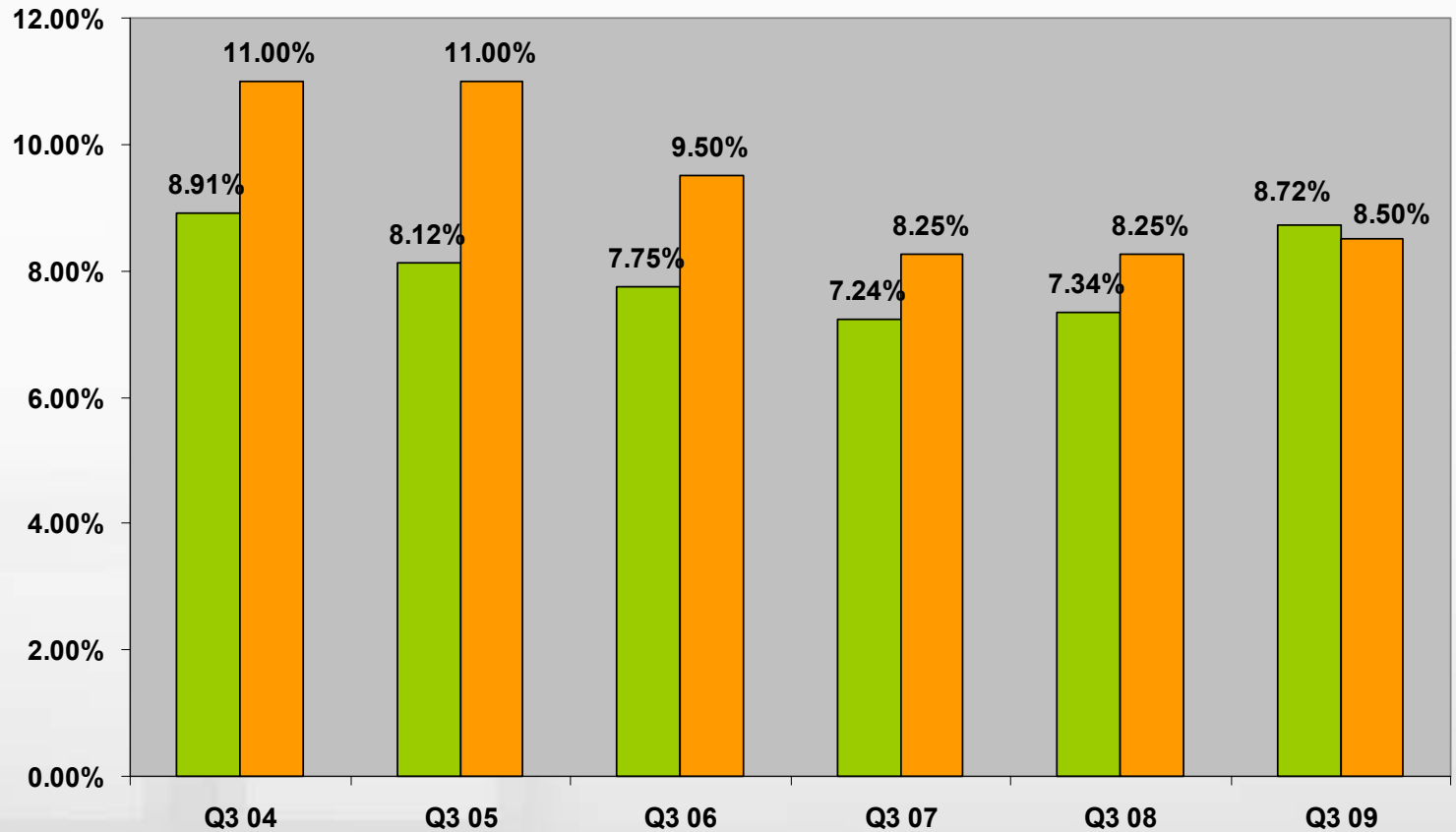




# CBD Office



 National - Quarter 3  
 Pittsburgh - Forecast for year

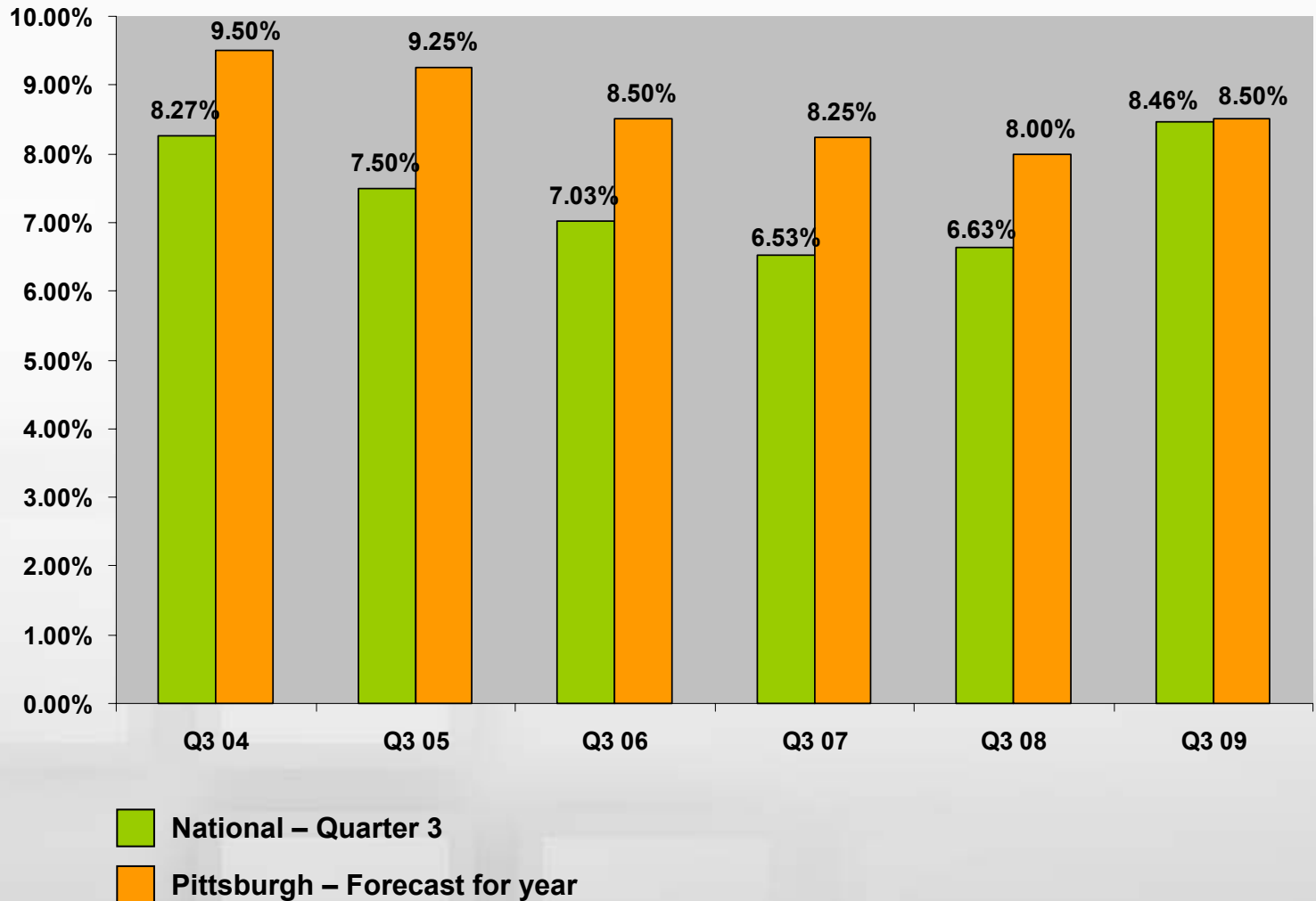
# Suburban Office



-  National - Quarter 3
-  Pittsburgh - Forecast for year



# Warehouse





# The Future...What causes capitalization rates to change?

- Capitalization rates decline when investors forecast the return on investment will increase during the holding period.
  - Increases occur in the form of
    - Increases in NOI caused by
      - employment and population increase
      - contractual rent increases
    - Favorable financing leverage
    - Undersupply of a product type



# The Future...What causes rates to change?

- Capitalization rates increase when the opposite trends occur.
- Pittsburgh has had higher “cap” rates than reported nationally because:
  - Net income levels have grown more slowly because the region has had limited population and employment growth.
  - Pittsburgh is considered a tertiary investment market which attracts fewer investment dollars than higher tier cities.



# Why do capitalization rates differ for the same property type?

- Age and condition of the property
- Length of the lease term
- Level of rent growth
- Location of property
- Balance of supply and demand
- Cost of re-tenanting
- Creditworthiness of tenant(s)



# The Future...

- Nationally
  - Current cap rates are likely to go higher if:
    - The commercial real estate market becomes oversupplied because of the inability of owners to refinance properties (foreclosures).
  - Current cap rates are likely to decline if:
    - Availability of credit and credit terms improve.
    - Demographics improve including higher employment and increasing population.





# Forecast

- Cap rates nationally are unlikely to change significantly until the...
  - commercial real estate refinancing problem is solved.
  - economy grows, increasing demand for retail space, apartments, office space, and industrial space.
- Over the long term, Pittsburgh will continue to have comparatively higher cap rates than the nation as a whole.
- However, Pittsburgh's comparatively stable economy has resulted in current cap rates which are likely to remain closer to national averages in the short run.



# Forecast

- In Pittsburgh...
  - the multi-family sector will continue to have the lowest rate of the major property types. A lack of new product and comparatively better financing alternatives will limit upward pressure on multi-family rates.
  - cap rates for retail properties are likely to remain historically high because of weak retail demand.



# Forecast

- In Pittsburgh...
  - cap rates for suburban office properties in the north and south submarkets will be the lowest because demand is the highest.
  - the Pittsburgh CBD office market will continue to see primarily double-digit cap rates because of limited rent growth, increasing expenses, and higher turnover costs.





# Questions or Comments...

## Contact Information...

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# Follow-Up



***Thank you!***

For attending this presentation. Please email Mary Amore at **mamore@irr.com** to receive a copy of today's presentation.



In addition, if you are interested in receiving a copy of the upcoming ***2010 Viewpoint*** publication, please indicate that in your email.

