



WOODS: Too many contractors misleading prospects



VOICES FROM THE INDUSTRY
Jeremy Woods

Caveat emptor. The phrase is well-known to anyone who has dealt with real estate. But the bursting of the real estate bubble has made that phrase even more compelling for businesses thinking about building a new facility.

These challenging economic times have pushed many people

in every aspect of the real estate transaction to adopt a myopic, reckless, every-man-for-himself mentality.

Contractors are finding it particularly challenging in this environment. Like any industry, there are good and bad examples.

But it seems the bad ones have grown more desperate by representing that low construction costs are the end-all to determining whether to build. They're playing up low costs of land and construction but overlooking longer-term costs either due to lack of information or by design.

This problem started early last year after the bust, but is getting worse as contractors finish projects and scramble to sign new work before their pipelines run empty.

It's true that construction costs are low. For example, a large distribution facility can be built for \$22 a square foot today compared to \$28 a foot just two years ago.

With prices so low, how could a business possibly lose?

If the business never intends to sell the building or grow out of it, perhaps they'll be fine. However, "never" is a long time, and if the business cannot predict the future with such certainty, it needs to consider an exit strategy.

This is where some potential clients are getting into trouble. It actually might be more important to decide how to sell the building than whether to build it in the first place. But they might not be thinking in those terms when contractors wave low prices in front of their eyes.

Real estate by its very nature is an illiquid investment. It's

tougher to sell than most assets even in the best of times.

Today, clients are unwittingly creating problems by assuming they can sell the building on terms that were standard during the go-go years. Those terms are long gone and the new terms are less favorable to sellers.

One of the most popular and profitable exit strategies was selling the building to an investor—either empty or under an agreement where the business stayed in the building and leased it back from the investor.

However, the prices investors are willing to pay have fallen even further than construction prices.

The reason has nothing to do with the fact the client paid less to build it; investors don't particularly care about construction prices. What they care about is the return on their investment and the risk associated with it, and right now they demand a high yield to account for the risk of operating in an uncertain economy.

That equates to a lower sale price for the client.

In other words, construction costs are lower, but so are returns on the investment to the business, because investors have increased their demands.

The message here is that it's a simple math equation, but businesses must finish the equation. They cannot just do the first part and skip the second.

Anyone considering taking advantage of cheap construction prices should analyze the overall real estate equation based on their specific needs and situation and considering all the factors, refusing to be swayed by people making a case on only one piece of the puzzle.

That one piece might just be the piece that hides reality.

That's why now, more than ever, the phrase "buyer beware" rings true. •

Woods, CCIM, SIOR, is a senior vice president at Summit Realty Group. Views expressed here are the writer's.