

THE GAP NO ONE WANTS TO PRICE

Commercial Real Estate, Replacement Cost, Investment Value, and How the Divergence Actually Resolves

By Lanre Olutimilehin FRICS

There is a number every developer in Lagos knows: what it now costs to build a square metre of Grade A space. There is a second number every valuer knows: what that square metre is worth on the income it commands. The first has run far ahead of the second. And the market has delivered its verdict in the most unambiguous way possible: assets offered at replacement-cost values are not finding buyers.

That is not a failure of marketing. It is price discovery. Replacement cost is a ceiling on value, never a floor. No buyer is obliged to pay what it would cost to recreate an asset; they will pay what the income is worth. So, the question is not whether the gap closes at the seller's number. It is how it resolves — and who is positioned when it does.

How the Gap Opened

Naira depreciation repriced the import-heavy construction basket - steel, glass, mechanical and electrical systems, lifts, finishes - in hard-currency terms, and construction inflation compounded on top. The income side did not keep pace: rents, even where indexed in dollars, are collected against tenant covenants earning largely in naira, and yields stayed wide because the institutional capital that would compress them stayed away. For much of the prime commercial stock in Lagos, replacing the building today costs materially more than a rational investor will pay for it. When value sits below cost, development stops.

Five Ways the Gap Resolves

First, price discovery through the first set of transactions. Stuck markets clear the same way everywhere: a handful of motivated transactions through receiverships, loan resolutions, corporate exits, complete at income-based values and reset the comparable evidence.

Once two or three prime assets trade at, say, 60 to 70 percent of depreciated replacement cost, cost-anchored book values become indefensible and the wider market reprices. The reason this has not yet happened at scale is not disagreement about value. It is that crystallising the loss is intolerable for the balance sheets holding the assets. The gap persists because of the accounting consequences of admitting it, and it clears when the cost of holding exceeds the cost of confessing.

Second, time and nominal income growth. For owners with holding power, the gap can close from below. Naira rents reset upward at each review, scarcity from the stalled pipeline adds pressure, and at even static yields the capitalised value grinds toward cost. This path is genuinely available, but only to unlevered or lightly levered owners of institutional-quality assets. It is not available to anyone with a maturing facility.

Third, structures that let both sides disagree productively. This is where transactions actually complete while headline numbers remain irreconcilable. Vendor financing lets a seller book something closer to their number while the buyer pays out of income over time.

Earn-outs make part of the price contingent on performance, so the disagreement about the future is priced rather than argued. Sale-and-leaseback converts an occupier's covenant into the very income that supports the price. And the genuinely new route: contributing assets into a REIT or fund in exchange for units.

An owner who cannot find a cash buyer at their number contributes the asset at an independently validated value and takes paper instead of cash, converting illiquid bricks into semi-liquid units while retaining the upside as yields compress. I expect asset-for-units (in a REIT or fund) to

become an important route by which prime Nigerian assets change hands over the next five years.

Fourth, yield compression from institutional capital. As pension capital flows through the new generation of REITs, the marginal buyer's required yield falls and investment values rise toward cost. This is real. It is also measured in years, and it depends on the supply of qualifying vehicles.

Fifth, the write-down that never bridges. For some assets the gap is permanent. Over-specified buildings whose income can never support their construction cost are not mispriced; they are misconceived. The replacement cost of an asset no rational person would replace is not a relevant number. Value is recovered through conversion to highest and best use, or accepted as a loss. The valuer's discipline is to say so.

The Playbook

For owners: stop waiting for the cash buyer at replacement cost. Structure instead: contribute into a vehicle, offer vendor terms, defer consideration against performance. And keep assets institutional-grade, because well-let, well-documented properties clear first and at the tightest discounts.

For lenders: the relevant collateral number is what the asset fetches from an actual buyer, at an actual yield, in an actual timeframe. Facilities secured against cost-derived valuations are secured against numbers at which no transaction will occur. Provision toward transactable values before the market does it for you and insist on market and investment value bases alongside any cost approach.

For new investors: while the gap persists, buying beats building. Acquiring standing assets below replacement cost is the closest thing this market offers to a structural margin of safety, and the first transactions are where that margin is widest. Development returns when value meets cost; investors holding well-located standing assets through the repricing will also hold first call on the development sites that follow.

The Valuer's Duty

The gap between cost and value is only dangerous when it is hidden, that is, when depreciated replacement cost is presented as market value and balance sheets rest on numbers no buyer will pay. Nigerian valuation practice, under IVS discipline, must be unambiguous about basis of value and unafraid to report figures that disappoint. The market cannot price the gap it cannot see.

The gap will resolve. The only questions are through which of these five doors, and who is standing in front of it.

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