

MERCURY  REPORT
Small-Cap Rent Series
Boxwood Means, Inc.



NATIONAL & REGIONAL TRENDS UPDATE
U.S. SMALL-CAP REAL ESTATE MARKET
JULY 2010

August 15, 2010

Summary

- Signal strength emanating from small commercial property markets is more positive and consistent. Rents are stabilizing, leasing activity is improving and for-sale property prices are firming up. While fundamentals are far from healthy, the market's compass is clearly pointing northward.
- **Asking rent** changes underscore the improvements posted in July. **Industrial** rents eased just 0.39% (39 basis points) – the smallest rent loss in almost two years. The decrease in **retail** rents, off by 0.22%, was the least in 29 months. **Office** rent losses also narrowed last month (-0.30%), while **shopping centers** (-0.38%) recorded a trivial increase over June. Year-over-year rent reductions for all property types are now well below 10% (see the table on Pg. 5).
- Boxwood's **Days on Market** indices show continued moderation (see the trends on Pg. 6). Leasing demand is slowly increasing among small businesses and tenants resulting in slight improvements in marketing time for available space. Average Days on Market for shopping centers narrowed slightly to 221 days, remained steady at 180 for industrial, and rose modestly for retail (191) and office (198) sectors. Leasing activity varies considerably by market, but tenants generally remain extremely cautious.

Summary – Cont’d

- Wariness among space users shows up in the latest small commercial property vacancies. As of second quarter, the aggregate commercial **vacancy rate** rose 38 basis points to 11.2%. Only 9 of the 98 metro areas tracked by Boxwood posted vacancy declines over the last 12 months. As the scatter diagram on Pg. 8 indicates, there is a positive association between past and present vacancy movements – i.e., metros with below-average vacancy *changes* over the past year continue to recover while markets with above-average changes over the longer term are still lagging. Such relationships offer lenders and investors insight into risk-reward trade-offs in market selection and investment. Also, see Pg. 9 for markets posting the best and worst vacancy rates. Boxwood’s U.S. small CRE vacancy rate, an all-inclusive index of business and commercial occupancies, is heavily weighted towards small establishments and tenants.
- **Asking sales prices** firmed up last month as small-cap property sellers gained their footing in a stabilizing marketplace. Price reductions for industrial properties (-1.45%), office (-0.82%) and retail (-0.88%) were small compared with June – and these prices haven’t tapered as much in nearly a year and a half (see Pg. 7). Granted, portfolios of sub-performing loans and distressed assets continue to come to market with the potential to further compress prices. That being said, loan sales volume has been quite measured to date, sidestepping (for now) market indigestion and allowing sellers to extract better prices.

Summary – Cont’d

- While we may be witnessing a market inflection, shifting economic winds make visibility awfully difficult. Yes, the small commercial property market has bottomed out. But the trajectory of property fundamentals remain vulnerable because of a weakness in aggregate economic demand: it limits the small business formation and jobs growth that spurs more office and industrial usage by tenants; and it dampens consumer expenditures that fuel retail shop expansions. Small-cap CRE markets will likely to bounce along the bottom with soft rents, elevated vacancies and brittle property values until such time that the economy cranks up further.
- National property values in the broad CRE market declined roughly 40% peak-to-trough per the Moodys/REAL index. Against the backdrop of \$1.5 trillion of CRE loans sitting on bank balance sheets, it’s no surprise that doomsday scenarios continue to swirl about community bank insolvencies, the insurmountable equity gap to borrower refinancing, and general challenges to lending and investment. But what if collateral values on the vast majority of bank CRE loans have NOT been smoked by 40%? Instead, what if it were closer to 25% because (a) most bank CRE loans are small, and (b) small CRE collateral values have held up better than larger assets? Would it not suggest that assumptions about refinance capacity, capital reserves, market recovery, etc., might be rather pessimistic or extreme?
- Later this month we will introduce Boxwood’s **U.S. small CRE sales price index** that exclusively tracks commercial property sale transactions under \$5 million – the zone least understood and perhaps oversold.

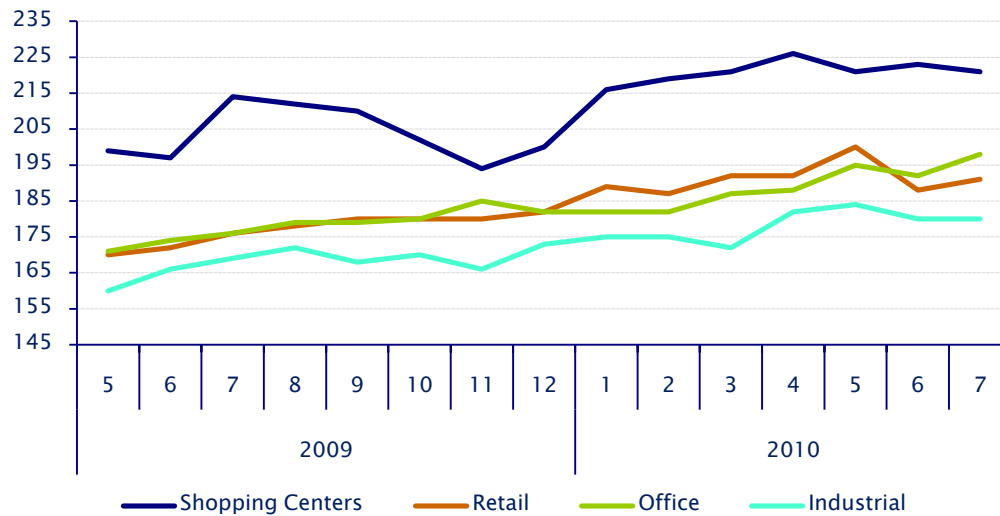
National Rent Levels and Changes

Property Type	July	June	1-Mo. Chg.	3-Mo. Chg.	12-Mo. Chg.
Industrial	\$6.93	\$6.95	-0.39%	-1.46%	-7.93%
Flex	\$8.61	\$8.63	-0.32%	-1.14%	-5.78%
Manufacturing	\$7.83	\$7.87	-0.42%	-1.44%	-7.28%
Warehouse	\$7.23	\$7.26	-0.39%	-1.41%	-7.46%
Office	\$17.16	\$17.21	-0.30%	-1.02%	-4.83%
Medical Office	\$18.69	\$18.73	-0.23%	-0.66%	-2.82%
Retail	\$17.26	\$17.29	-0.22%	-0.95%	-5.38%
Street Retail	\$17.16	\$17.22	-0.37%	-0.93%	-5.60%
Free Standing Bldg.	\$15.47	\$15.48	-0.07%	-0.42%	-4.98%
Other Retail	\$16.68	\$16.74	-0.36%	-1.18%	-5.61%
Shopping Centers	\$17.26	\$17.33	-0.38%	-1.07%	-5.17%
Strip Centers	\$16.22	\$16.29	-0.40%	-1.26%	-5.63%

Source: Boxwood Means, Inc.; LoopNet, Inc.

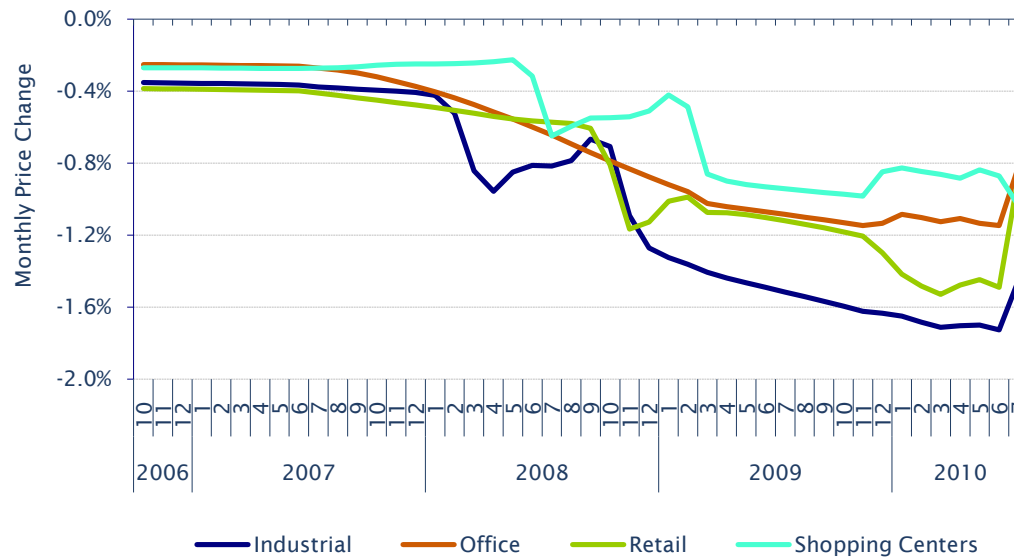
Days on Market Trends

Days on Market Trend – U.S. Averages
 From Market Availability to Lease Closing



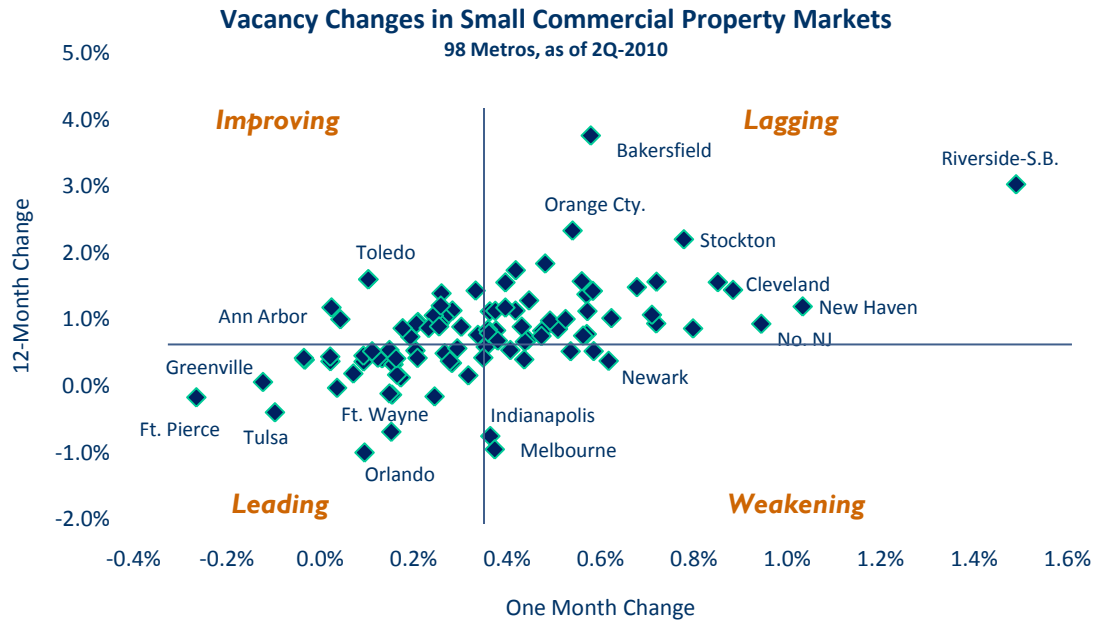
Source: Boxwood Means, Inc.; LoopNet, Inc.

Asking Sales Price Trends



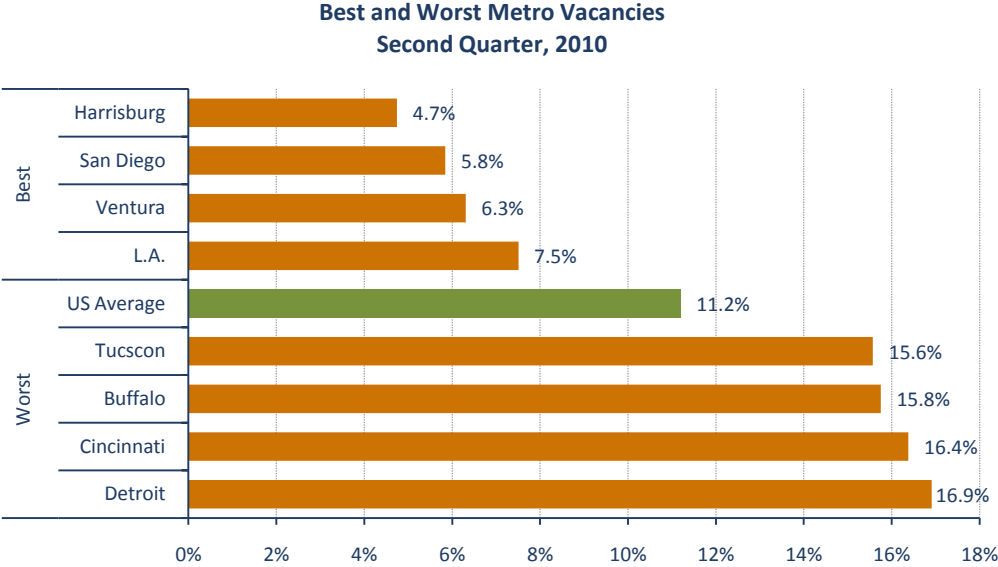
Source: Boxwood Means, Inc.; LoopNet, Inc.

Vacancy Rate Movements



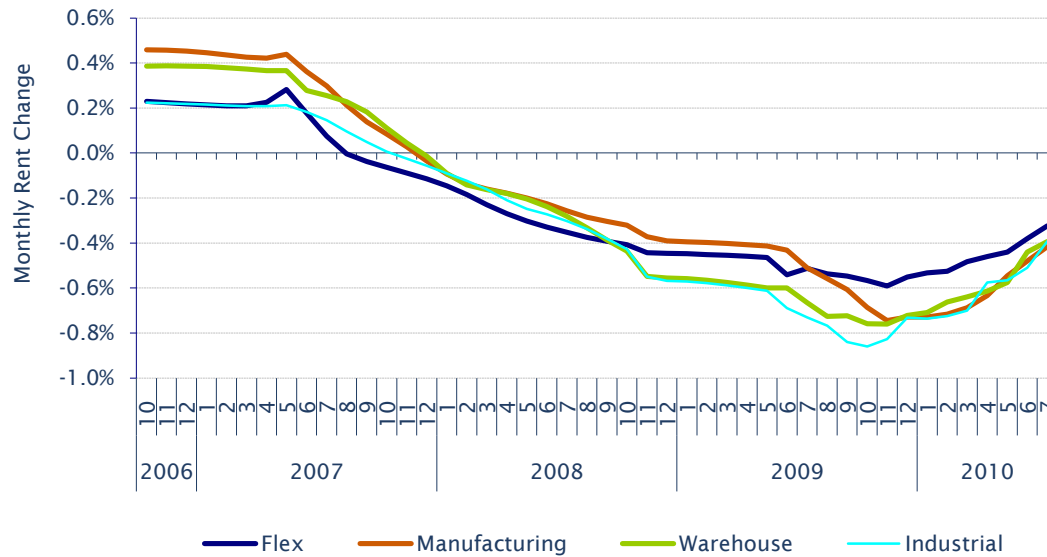
Source: Boxwood Means, Inc.

Notable Market Vacancy Rates

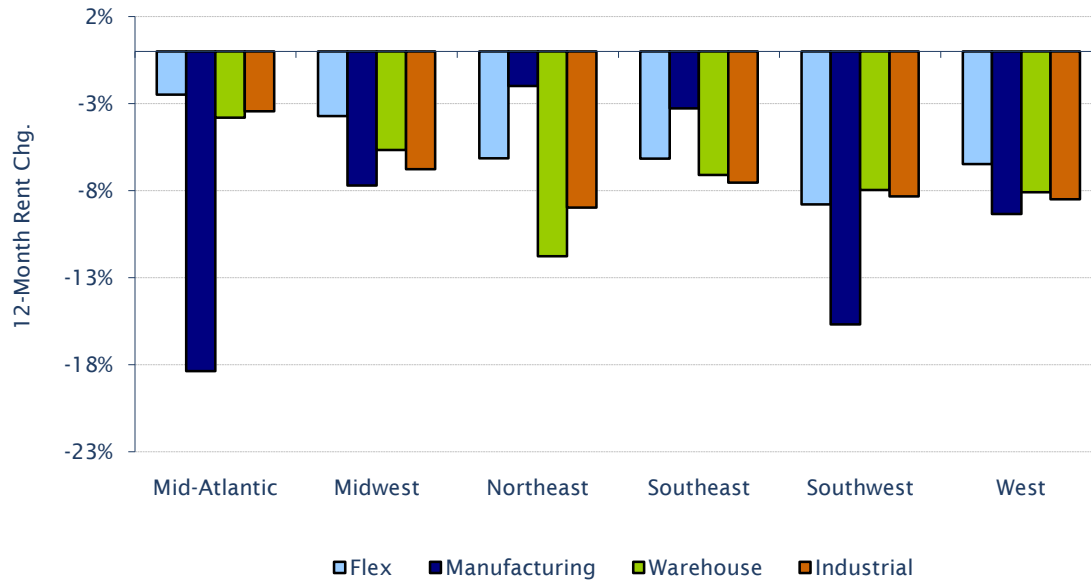


Source: Boxwood Means, Inc.

National Industrial Rent Trends

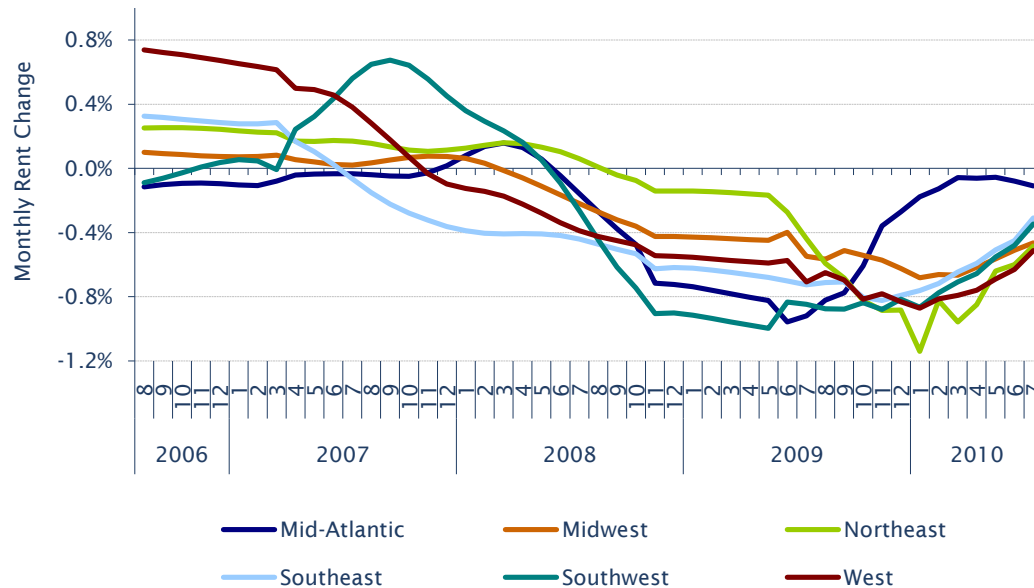


Regional Industrial Rent Comparisons



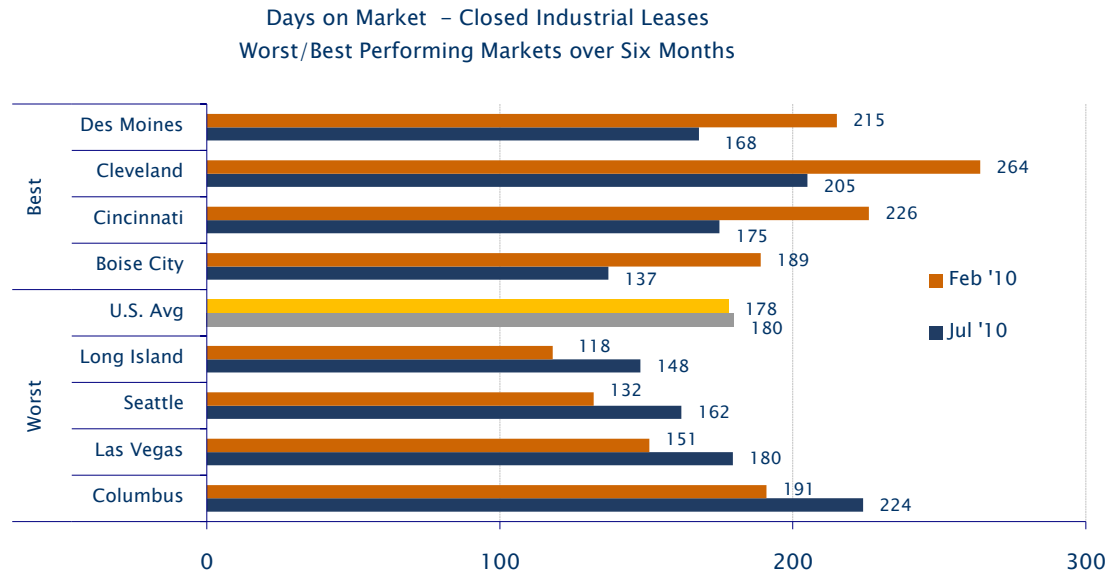
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Industrial Rent Trends



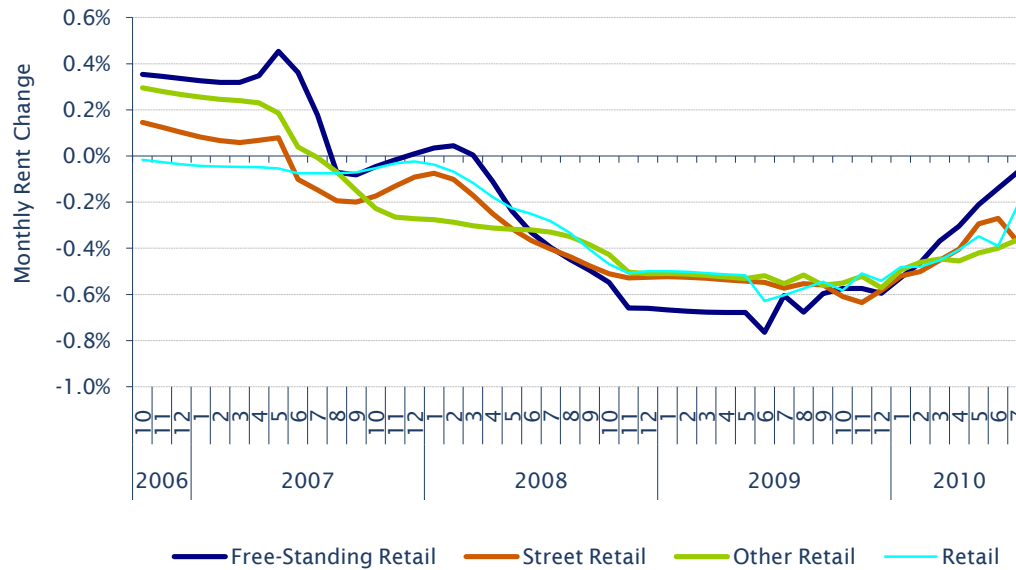
Source: Boxwood Means, Inc.; LoopNet, Inc.

Leasing Conditions – Selected Industrial Markets



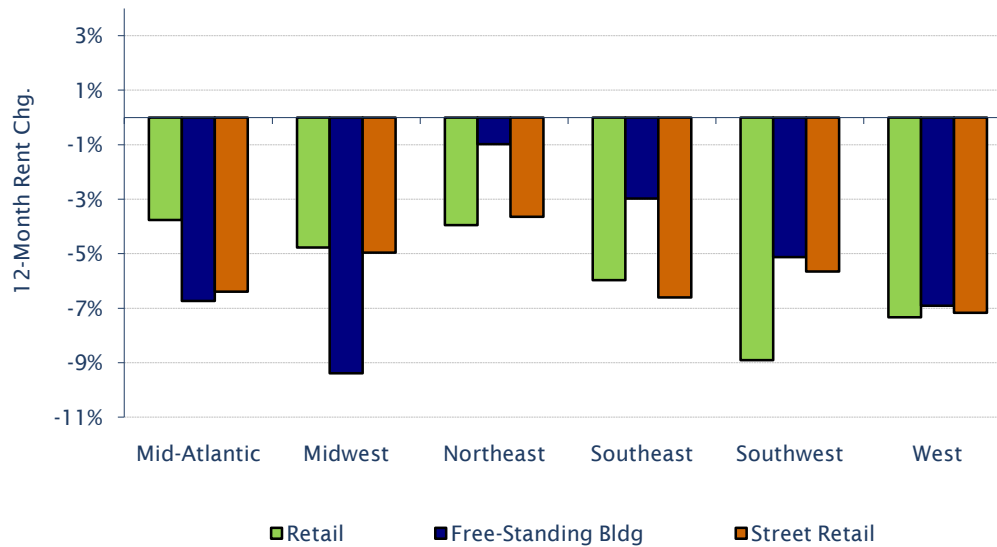
Source: Boxwood Means, Inc.; LoopNet, Inc.

National Retail Rent Trends



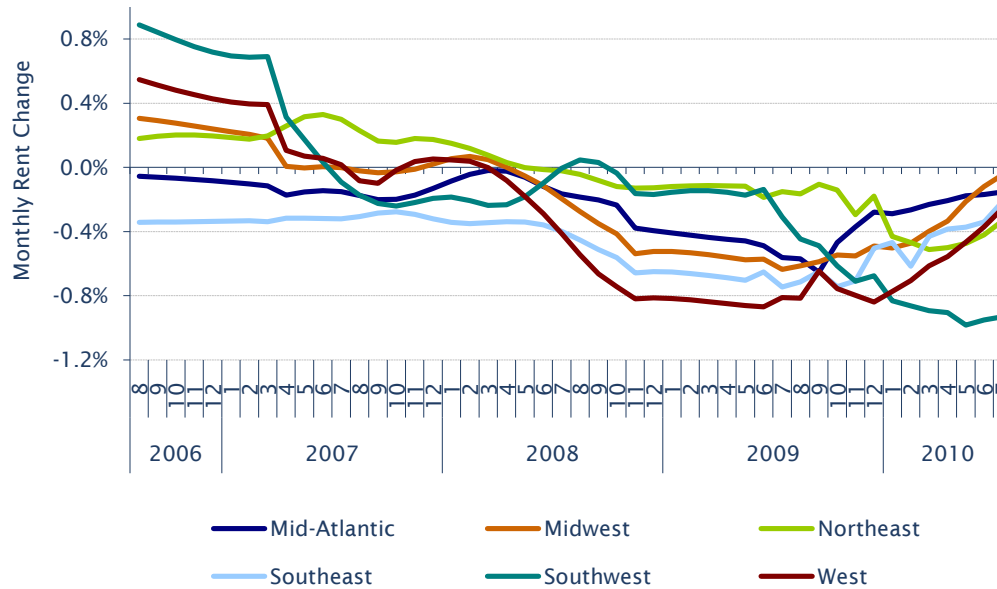
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Retail Rent Comparisons



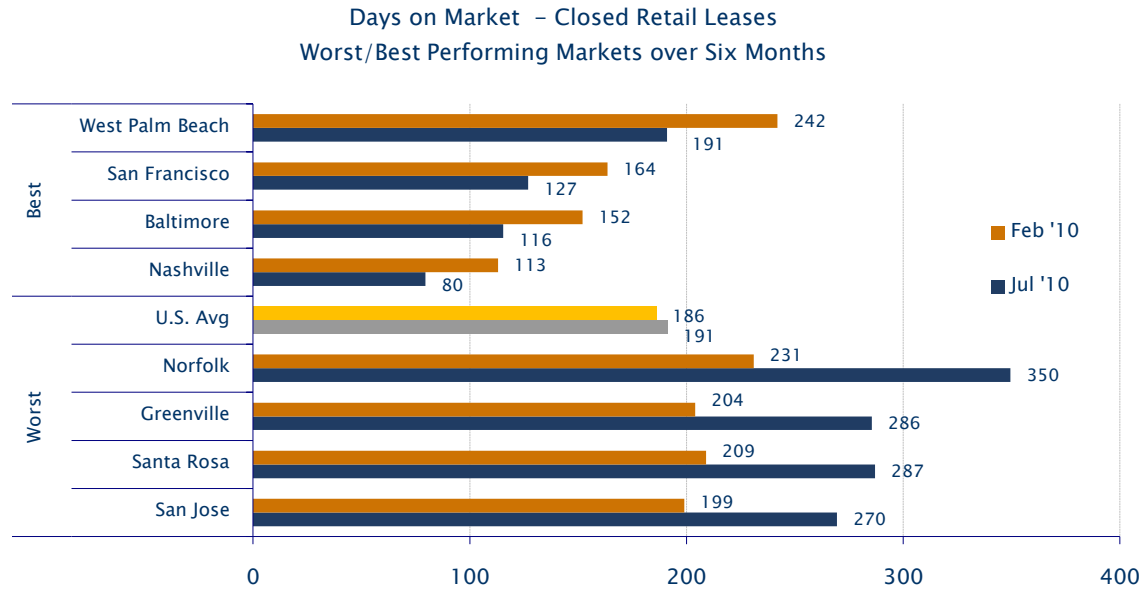
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Retail Rent Trends



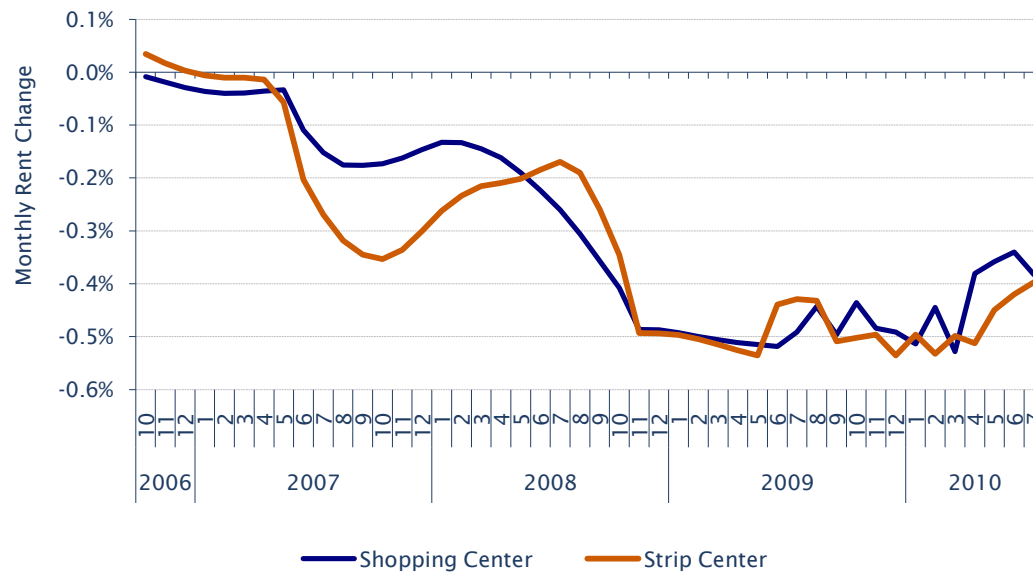
Source: Boxwood Means, Inc.; LoopNet, Inc.

Leasing Conditions – Selected Retail Markets



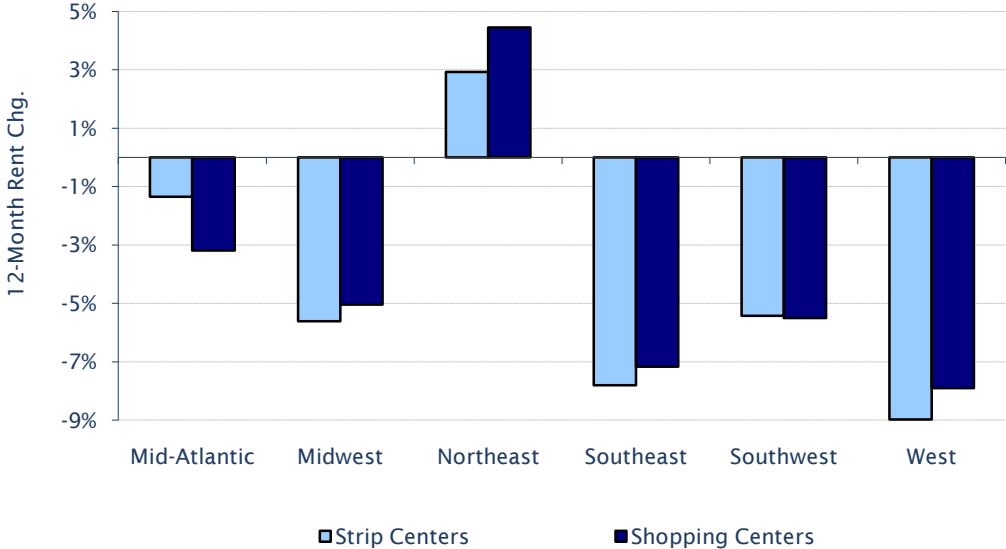
Source: Boxwood Means, Inc.; LoopNet, Inc.

National Shopping Center Rent Trends



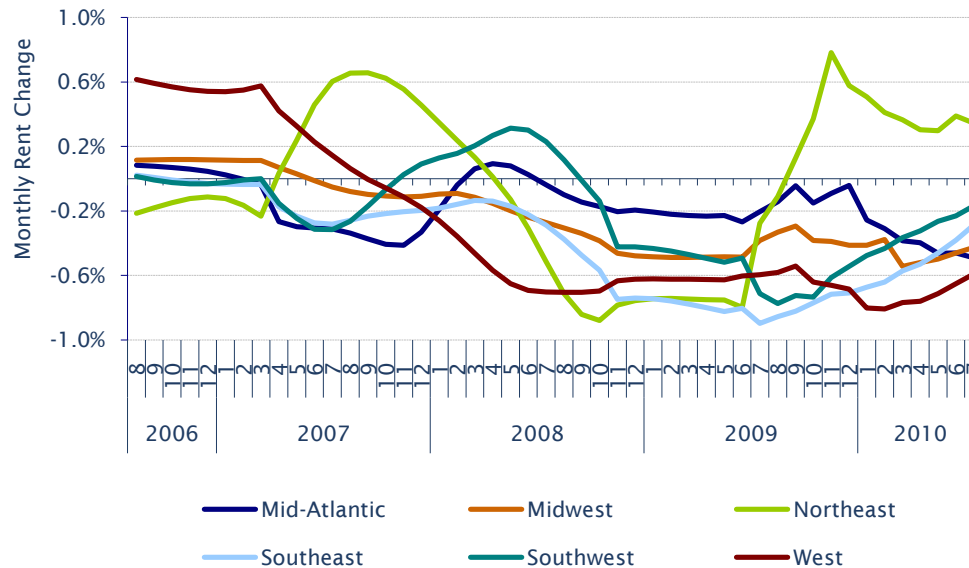
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Shopping Center Rent Comparisons



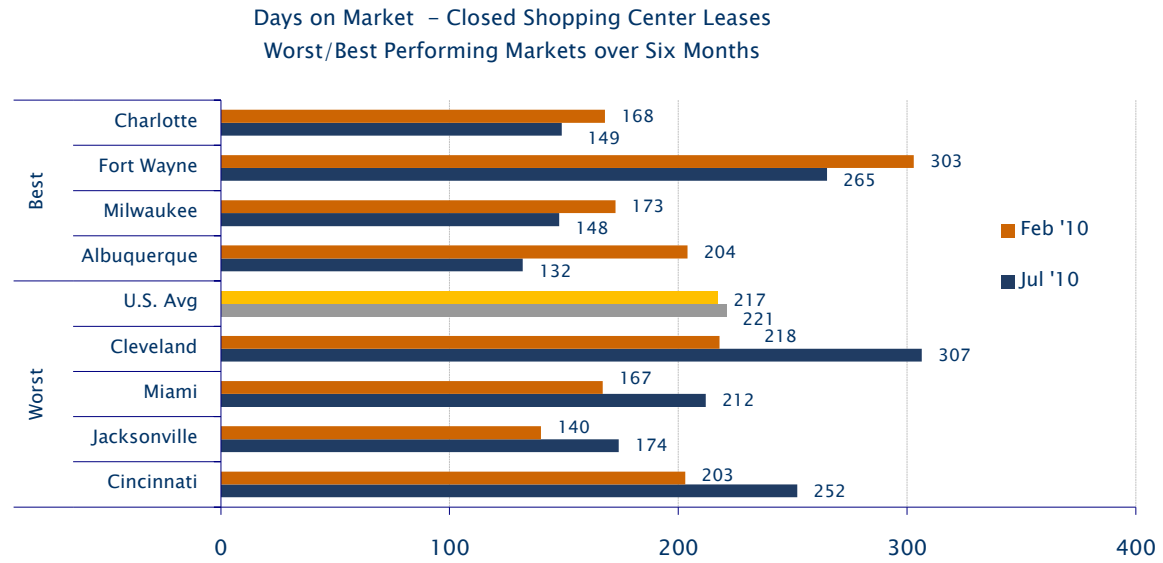
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Shopping Center Rent Trends



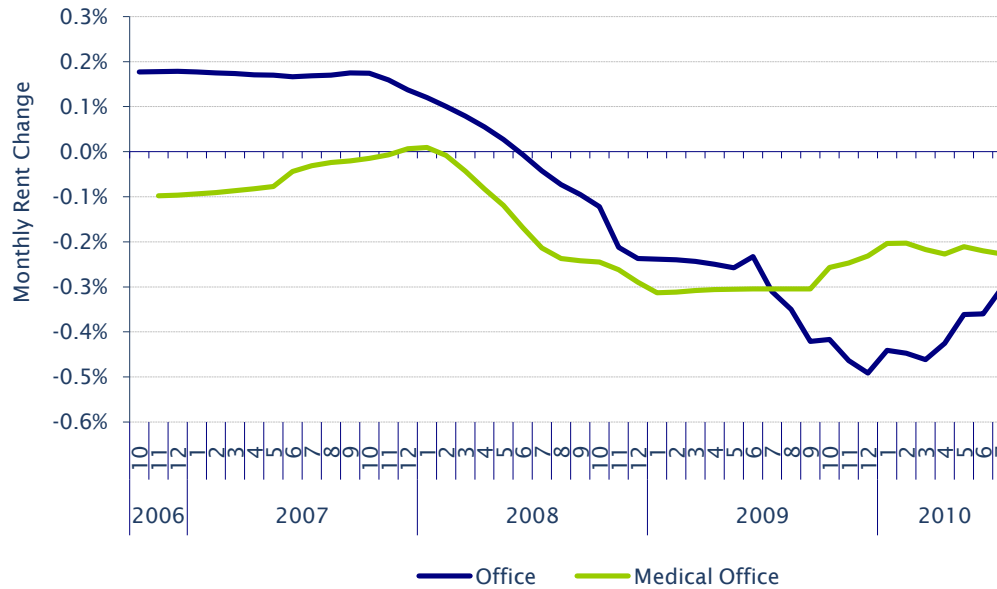
Source: Boxwood Means, Inc.; LoopNet, Inc.

Leasing Conditions – Selected Shopping Center Markets



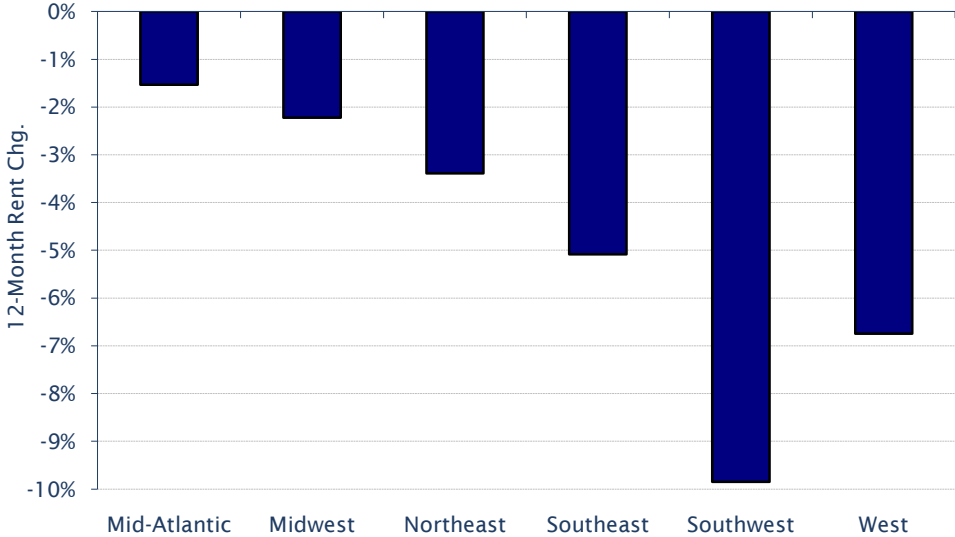
Source: Boxwood Means, Inc.; LoopNet, Inc.

National Office Rent Trends



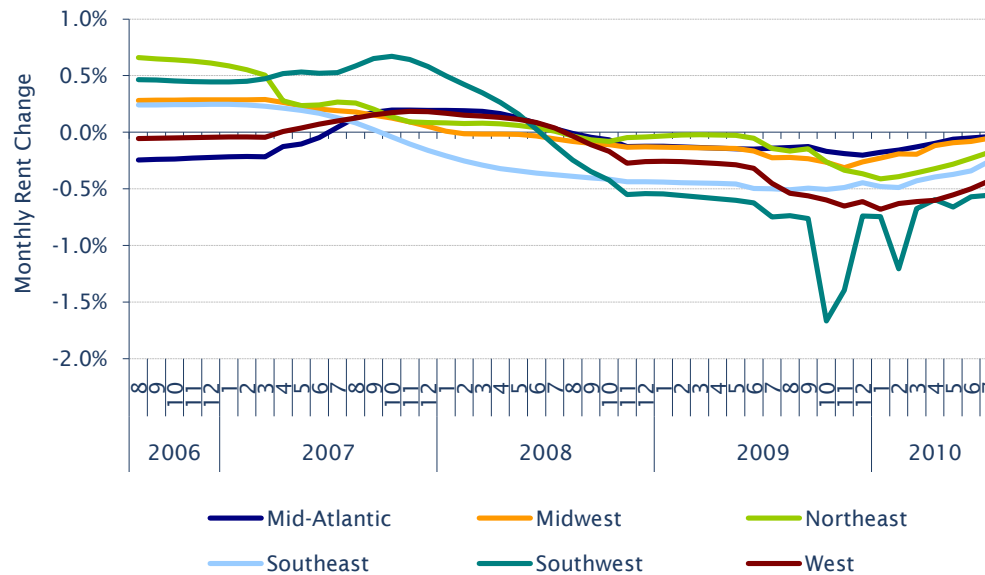
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Office Rent Comparison



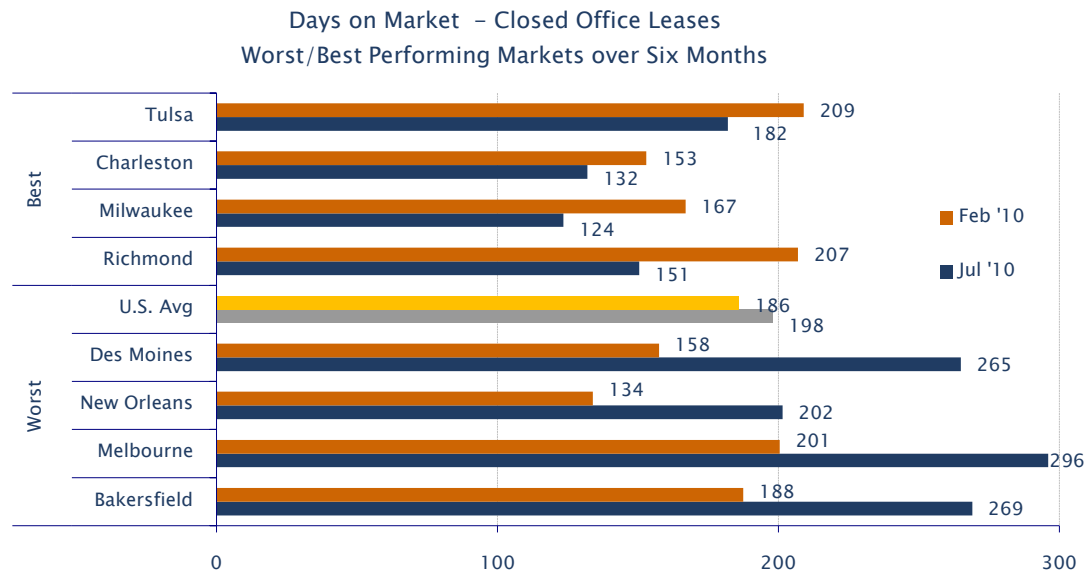
Source: Boxwood Means, Inc.; LoopNet, Inc.

Regional Office Rent Trends



Source: Boxwood Means, Inc.; LoopNet, Inc.

Leasing Conditions – Selected Office Markets



Source: Boxwood Means, Inc.; LoopNet, Inc.

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