Commercial RealEstate Direct

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Cap Rates for Most Small Commercial Property Types Increased in 4Q

Capitalization rates for relatively small commercial properties - those with up to 50,000 square feet each - increased in the fourth quarter for three of the four major property types tracked by Boxwood Means Inc.

The Stamford, Conn., provider of valuations, research and analytics on the small-cap property sector, estimated that the average cap rate for retail properties increased by 30 basis points to 6 percent, that for multifamily properties increased by 20 bps to 5.2 percent and that for industrial increased by 10 bps to 6.5 percent. The exception was the office sector, where cap rates declined by 20 bps to 6.8 percent.

Cap rates had increased by 20 bps across the board during the third quarter as well.

Boxwood Means' cap rate estimates reflect its analysis of data on small-cap properties from CoStar Group.

That helps explain the middling 1.9 percent, or $65 billion, increase in the total equity market value for the small-cap sector from 2021, to $3.5 trillion. Boxwood Means noted that the industrial property sector outperformed, with an 8.3 percent gain in valuation, to $900 billion, while the multifamily sector grew by 1.4 percent to $500 billion. The office sector grew by 0.4 percent to $700 billion, while the retail sector declined in value by 0.8 percent to $1.4 trillion.

Despite the marginal increase in value during 2022, the small-cap property sector has ballooned in value by 40.1 percent since mid-2020, when efforts to stem the coronavirus pandemic hammered property values.

The market's value had ballooned by 23.4 percent in the third quarter of 2021. It's continued to increase in value quarterly since then, but that rate of growth has slowed appreciably.

Boxwood Means noted that sales transaction volume also has slowed, largely driven by the increase in cap rates. As cap rates increase, prices decline, all other things remaining unchanged. As a result, property owners might be loathe to sell into a declining market.

Still, the company noted that compound annual growth rates for small-cap properties remained healthy, with a 23.3 percent annualized return for multifamily properties; 10.3 percent for industrial; 9.1 percent for retail; and 7.8 percent for office.

The overall return for the fourth quarter was 11 percent, down from 14 percent in the third quarter.

The company said valuations might continue to soften, given higher inflation and interest rates. But it noted that its preliminary analysis of demand shows a light increase in net absorption across the board.