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There's No Room in the Small-Cap Property Market

Net absorption in the small-capitalization property market took it on the chin during the first quarter, declining by a whopping 90 percent from the previous quarter to only 1.9 million square feet of office, retail and industrial space, according to Boxwood Means.

Worse still, the industrial sector saw negative net absorption of 3.3 million sf, down 144.4 percent from a year ago. That was the first quarter in which the industrial sector saw negative absorption, which means previously occupied space became vacant.

Absorption in the retail sector saw a 70 percent decline from the previous quarter and the same period a year earlier.

But the weak absorption numbers weren't necessarily due to a lack of tenant demand. Instead, it's because small businesses, which are the target tenants for small-cap properties, are having such a difficult time finding qualified workers that they're holding off any expansion plans. Citing data from the National Federation of Independent Business, Boxwood Means said 54 percent of small business owners reported finding few or no qualified workers for positions they had open. And 39 percent of all business owners said they couldn't fill open job positions during the first quarter.

Meanwhile, developers are simply not adding as much small-cap space as they have been.

Randy Fuchs, principal and co-founder of the Stamford, Conn., provider of valuations, research and analytics on the small-cap property market, added that the drop in absorption was also a "supply-side issue," rather than a demand problem. He authored a blog on the Boxwood Means website.

Deliveries during the first quarter totaled 19.2 million sf. That's not much less than the 20 million sf quarterly average since 2010, but it's down 48.4 percent from the same period a year ago and down 5.4 percent from the fourth quarter. So, even if small businesses were actively looking for expansion space, they likely had a hard time finding it. The market, Fuchs wrote, simply hasn't kept pace with demand.

That could, in a sense, be a good thing, as most real estate cycles peak as development expands. "So, this development - or non-development - is a bit puzzling," Boxwood Means said in its latest market update.

Big and small tenants, the company said, are increasingly targeting expansion, or new space, within urban areas. That's driven occupancy levels to all-time highs, with availabilities for small business owners and tenants becoming "increasingly rare."

The lack of space drove rents in the small-cap office sector up 1.5 percent in the latest quarter, when compared with the previous quarter, to $20.52/sf. They were up 4.5 percent from a year ago and are up 7 percent from the previous market peak.

Retail rents were up 1.2 percent in the latest quarter to $19.13/sf and are now 7.7 percent higher than during the previous market peak. And industrial rents were up 2 percent to $9.64/sf. They're up 24.6 percent from the previous peak in 2008.

Boxwood Means analyzes national data, so it's unable to assess market-by-market changes. While urban areas are as tight as a drum, it's likely that some suburban and ex-urban areas have plenty of space availabilities.